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FCC'S TAX CERTIFICATE PROGRAM

HEARING

BEFORE THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MARCH 7, 1995

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FCC'S TAX CERTIFICATE PROGRAM

TUESDAY, MARCH 7, 1995

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:00 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the committee) presiding.

Also present: Senators Moynihan, Baucus, Bradley, Rockefeller, Breaux, Conrad, Graham, Moseley-Braun, Dole, Grassley, Hatch, Simpson, Pressler, D'Amato, Murkowski, and Nickles.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order, please. Congressman Rangel has asked me to offer his apologies. He wanted to be here today to testify very badly. His mother died yesterday and he is obviously in New York and taking care of those arrangements.

Before I call on the first panel I want to lay out some ground rules, if I might. This has been, to me, a most interesting subject. And, as usual, nothing is ever as it quite meets the eye when you read about it or hear about it for the first time.

This is an interesting mix of FCC policy, a history of civil rights enforcement, and the tax law, all coming together in one confluence—perhaps unintended confluence—by the authors of different policies at one time or another, but they all happened to meet in this issue we have before us.

First, I will take the civil rights part. Of course, no one has to argue, is that there is a long history of discrimination in this country, in the world. Rather, it is the test axe in England and anti-Catholic axe. Even to this day, the monarch in England cannot marry a Catholic by law. It still exists to some extent. The Klu Klux Klan, will not refer so much to its anti-black bias as its anti-Catholic bias, because we have an interesting history in Oregon.

Senator MOYNIHAN. Took over your State legislature in the 1920's.

The CHAIRMAN. Took it over in the 1920's.

Senator MOYNIHAN. Got to keep an eye on you.

The CHAIRMAN. Passed a law, believe it or not, outlawing private schools, Catholic schools particularly.

Senator MOYNIHAN. Society of Sisters.

The CHAIRMAN. Society of Sisters, one of the early cases. Society of Sisters, being the Catholic educational order, vs. Pierce, Pierce being the Governor, went to the Supreme Court.

The Supreme Court declared our law, correctly, unconstitutional. But it was one of the first privacy cases. These did not come with the abortion cases, they came in the 1920's and 1930's, and that was one of the first decisions heavily based upon privacy.

Then, of course, you had the discrimination in the Ivy League colleges in the 1930's, 1940's, and even 1950's, as far as I know, about only a certain percentage of Jews could be admitted, or a certain percentage of Asians. We are rife with discrimination in our past. There is no question about it.

But what was intriguing was our view of enforcement, because initially the enforcement was, if there is an individual wrong, there is an individual remedy. If you were denied the right to get into a school or to buy a house in a certain area, you sued, and if you proved discrimination, you got the remedy. It was much more typical of our law.

Then we moved into what I would call a class entitlement, and it came really with the Philadelphia plan. Here, Mr. Former Chairman, and my good friend, there is great advantage in having been here long enough. I was able to go to the source, Larry Silberman, who was the Under Secretary of Labor in 1969, now on the Court of Appeals. His wife was my press secretary for a number of years. He drafted the Philadelphia plan.

And what you had in the Philadelphia building trades was a long history of discrimination, although he kind of mused, while it was clearly anti-black, it was also anti-everybody who was not related to somebody who was already in the building trades. Your cousin got in, or your nephew got in, but nobody else got in. But, as there were never any blacks at all in the trades, why, no blacks got in.

But at this stage the Philadelphia plan decided, rather than trying to say, was Johnny Jones discriminated against, and was Eddie Brown discriminated against, they would simply set a goal that the trades had to hire so many minorities by a certain period of time.

And he said the Johnson Administration had been somewhat reluctant to set that standard because it smacked of quotas. We talked about goals, we talked about getting from one place to another, but finally in the Philadelphia plan we did it.

Larry Silberman, years later in an article in the Wall Street Journal, said he regretted it because there was no way that you could avoid quotas. You had to count. If you had to have 20 percent blacks hired by 1975, how else do you know if you are achieving that other than by counting, and what had been a goal became a quota.

The interesting thing was, that in all of these discrimination cases, whether it was, were you admitted to college in the 1930's or denied college or access, or in the Philadelphia plan, you had to prove discrimination.

We have since moved into an era where, in order to have a race conscious or other group remedy, you do not have to prove discrimination. This is the interesting difference that the court has made in affirmative action programs. If they are looking at a State or local government action, or a private enterprise action, they say

that you must have some proof of discrimination. Absent that, there is no remedy. You at least have to get over the initial hurdle.

If it is a Federal action, however, then the court will defer to Congress or to the agency. There does not have to be a specific finding of discrimination in order to have a race conscious remedy. It is a different standard that we apply to the Federal Government, or to Government agencies. So, that is the background on civil liberties and enforcement.

Now we come down to the FCC's diversity policy. It stems from what is known as basically an involuntary conversion law. We had a law that said, if your property was destroyed by flood or fire, you lost it by theft, or there was eminent domain, the government took it, if within 2 years you invested the proceeds from the insurance or the proceeds from the government in a similar property, you postponed the tax on it.

Well, in 1943 we passed the following. This is where Congress started getting into this with the FCC. "If the sale or exchange of property is certified by the Federal Communications Commission to be necessary or appropriate to effectuate a change in policy or the adoption of a new policy by the Federal Communication Commission with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, if the taxpayer so elects, be treated as an involuntary conversion if such property, within the meaning of Section 1033," 1033 being the involuntary conversion statute.

So, Congress passed this and we said to the FCC, you go ahead and if you make new policy or change policy you can use this involuntary conversion law. So in 1943 the FCC first applied it to the forced sale of radio stations. They did not want you to own two stations in one market; you had to get rid of one.

This was, in essence, a forced conversion and you could, therefore, take whatever profit you got from the sale of the station, and if you put it into another station within 2 years you postponed the tax. Then we went on in 1954 with the forced sale of television stations. But the interesting change came in 1970 when we applied it to certain voluntary sales.

Then we extended it to the voluntary sale of cable systems, and the voluntary sale of newspapers in the same markets. Then we came, in 1978, to the issue we now face, and this was the voluntary sale to minorities, and could the broadcasting station be regarded in the same sense as a forced conversion, and what the FCC said was yes.

We said involuntary sales in 1993 of sales by utilities. Utilities hold a number of broadcasting frequencies and if they were willing to sell them they could have this same forced conversion privilege.

So now you have got civil rights laws in the background, and the fact that at the Federal level you do not have to have any showing of discrimination. You have got a long history of the FCC in a variety of transactions saying, if you sell your radio station, cable station, newspaper, or whatever, you are entitled to this special privilege in the law.

Now we get down to the policy we are looking at today, and this is the sale of properties to minorities. The lead case on this—and this is what I found most intriguing—was the Metro Broadcasting

case in 1990. There was no finding at all of any discrimination in the sale of broadcast properties. None.

I talked to one broadcaster, although he was white, and he said, listen, if I want to sell my property I do not care if the guy has got blue skin and he has got an eye in the center of his forehead. If he has got the most money, he gets the property. This whole issue is not pinioned on any evidence of discrimination in the sale of broadcast properties.

But, remember, I said it is important in Federal actions to realize there does not have to be any finding of discrimination in order to have a race-conscious remedy. So the court applied the Federal standard in this Metro Broadcasting case and, in essence, deferred to the Federal Communications Commission.

But here was the most interesting part of this case. The FCC justifies their policy because it achieves diversity in broadcasting. And the record in the Metro case is absolutely full of evidence that minorities program differently than whites. There is no question about it. The case is so well-argued and so well-presented.

There is study after study, including a mammoth Congressional Research Service study indicating that minorities do not have the same stereotype of themselves as the stations owned by whites; that they broadcast differently, that they program differently.

The policy of the FCC was to encourage diversity in broadcasting. This was not for the benefit of the owner, it was for the benefit of the listener, and that the country would be better served by diverse voices in broadcasting and the evidence was, again, overwhelming that minority-owned stations programmed differently and, therefore, more diversely than whites.

So the hinge upon which the minority tax certificate sale program revolves around is not, should you sell to a minority for the sake of minorities owning stations, it is pinioned on the fact of diversity in broadcasting. The only way the FCC saw that they could achieve the diversity was to encourage the sales to minorities.

And here I will simply conclude with what the court said in Metro Broadcasting. It is two simple sentences. The FCC's conclusion that "there is an empirical nexus between minority ownership and broadcasting diversity is a product of its expertise, and we accord its judgment deference." And in their final statement, Congress "need not make specific findings of discrimination to engage in race-conscious relief."

So, I think the issue before us—and we have other issues; clearly we have the Viacom issue and whether or not there was retroactivity, and we will get to that this afternoon—but as to the certificates themselves, it is an old policy.

All of the other times, it was exercised to get diversity in broadcasting. You did not want Hearst owning the newspaper, the television station, and the principal radio station in a town. So, when you forced divestiture of those you allowed the tax certificates in the forced conversion and the tax preference.

This is all Congressional policy. This could all be changed by Congress. This is constitutional. The question, I guess, boils down to this: does Congress want to encourage ethnic diversity, racial diversity, minority diversity, in broadcasting? This is no longer the antitrust argument of, should Hearst own everything in the town.

Do we want to encourage that kind of diversity or not? If the answer is no, well, that is an easy enough answer. If the answer is yes, the question becomes, how, and is the FCC's policy a legitimate policy to reach the conclusion of diversity?

Senator Moynihan?

Senator MOYNIHAN. Your Honor, I think that was a brilliant exposition and I look forward to the testimony.

The CHAIRMAN. Senator Hatch.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Good morning, Mr. Chairman. Thank you for holding the hearing today.

We have before us a very interesting, complex, and controversial topic, it seems to me. The more I learn about Section 1071 the more facets I see to it. I think you gave a pretty good outline of the issues involved. The issue here certainly deserves our attention.

As the witnesses testify today, I hope to get answers to at least three questions. First, are the benefits available under Section 1071 so unreasonable and unjustified that we ought to repeal the entire section? Number two, if they are somewhat justified, what kind of modification should we make, if any, to the section?

And number three, is the application of Section 1071 in the case of the much publicized Viacom deal, is that case so abusive that it deserves to be shut down by retroactive application of new tax law, even if the parties to the transaction relied in good faith on the current tax law?

Now, I have to say at the outset that I am generally opposed to any legislation that retroactively and adversely changes the rules. Taxpayers rely on laws, rely on the rules, in order to make their decisions. In my view, individuals and corporations must be able to count on the current tax laws remaining in effect until Congress prospectively changes them.

So, I start out with that basic feeling. I will be interested in the testimony today, Mr. Chairman, and appreciate you holding this hearing.

The CHAIRMAN. Senator Grassley.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Well, Mr. Chairman, I know that this hearing is held today on the justification of the offset. I hope in the process of our considering this issue that we do not take our eye off the goal that we have, and that goal is the underlying provisions calling for the permanent extension of the 25 percent tax deductibility of health insurance.

I think it is long overdue that we make that permanent, and whatever sort of compromise is necessary to get the retroactivity of it through so that farmers and other self-employed people are able to qualify for it for last year, I think we need to do it.

I would like to point out one provision of the offset that I have some questions about, because I know we are concentrating just on the FFC provisions today. But there is another retroactive provi-

sion that appears to me to be unfair and that deals with the involuntary conversion provisions of the House bill, and I will call that to the attention of the Chairman more specifically at a later time.

I want to move forward though, so that we can get this legislation passed and have the unfairness that is in the present Tax Code for self-employed people on health insurance done away with.

The CHAIRMAN. Senator Moseley-Braun.

OPENING STATEMENT OF HON. CAROL MOSELY-BRAUN, A U.S. SENATOR FROM ILLINOIS

Senator MOSELEY-BRAUN. Thank you, Mr. Chairman. At the outset I would like to thank you for your exposition of the facts and the history regarding this section.

I was reminded, as you were talking, of an old expression that says, if you are not part of the solution you are part of the problem. The problem that this issue raises here today is the ugliness of racism and discrimination and the divisiveness that those issues pose for our community.

The question before us as I see it, is whether this committee will address that problem in a constructive, positive way that encourages community cohesiveness, as I think, Mr. Chairman, you have done in your opening statement, or allow the parasites of fear and prejudice to dictate a divisive, destructive, and inflammatory response to the volatile issue of affirmative action. We are, after all, all in this together.

Efforts and initiatives that seek to boost minority participation in the economic life of this Nation have at their core a commitment to giving every person a stake in the American dream and allowing every person to benefit from the rich diversity that this country has to offer.

That dream holds that the promise that we all can benefit, every one of us, without regard to race or gender, where each person is given the opportunity and the freedom to contribute to the total society to the maximum extent of his or her ability.

The beneficiary of that promise is not just the individual who may be the object of affirmative action initiatives, but the whole community which is enriched by the enhanced creativity and contributions, the energy and talent, of those who might not otherwise have had a chance to give.

And, in that regard, Mr. Chairman, I was particularly taken with your discussion of the issue of the findings regarding diversity and the importance of diversity of voices with regard to this section of the Tax Code.

At its core, affirmative action is about giving, not taking. It is about sharing in the great range of activities which define us as Americans. It is not a selfish concept.

It is not a form of reparations for past slights and injustices, but rather it confirms the notion that this generation of Americans is prepared to go forward together, bound together by a commitment to the values of equality and excellence, of community and coalition.

There are those who, without regard to the facts, would inflame passions with the notion that the inclusion of some means the exclusion of others, that a benefit to minorities requires a burden for

the majority, that white males have something to fear from non-whites and non-males. This committee has an opportunity to expose the fallacy of those fears.

The specific Affirmative Action Initiative represented in Section 1071 has had the effect of increasing minority ownership of the public airways from less than one-half of one percent to 2.9 percent, almost 3 percent.

When considering that minorities own only 362 broadcast and cable stations out of the vast number of them, surely the notion that this is an unfair preference is laid open. Moreover, one has only to ask the question, what does it serve the whole population to have even this level of involvement in broadcasting diversified?

I would argue, Mr. Chairman, that our diversity is our strength. It is the richness and the richness of the quilt of identities enacted to ensure diversity of voices in the public airways. That is what it has continued to do since its inception in 1978 to boost minority ownership.

A 1979 study compared two Detroit stations, one black-owned and one white-owned, and concluded that the overall mix of topic and location coverage between the two stations is statistically different, with its higher use of minorities in news maker roles and its higher coverage of issues of racial significance, the African American-owned stations content does represent a different perspective on news than white-owned stations. Again, Mr. Chairman, you referenced that in your opening statement.

Another study conducted by the University of Massachusetts surveyed 3,000 local Boston newspapers and found a statistically significant difference in the treatment of events depending on the race of the ownership.

To the extent that members may have concerns—and this gets to Senator Grassley or Senator Hatch's concern—that the program does, in fact, achieve its objectives, and that no fraud or abuse exists within the program and in the administration of the program. That subject, I believe, is ripe for examination here and I would look forward to the testimony with that regard.

But I hope that we will be able to address this issue in a constructive way and to find a way to fund the health insurance deductibility renewal in a way that does no harm. And I agree with Senator Grassley, we want to get that part of it done. We want to see that that is funded so that that can be renewed in time for the tax season.

We have a chance, by our example today, to be a part of the solution and to confront the real and perceived issues this debate raises in a way that will be a model for the country.

This committee should consider that, in this effort, we will send a message to the public at large. That message can either be a constructive and inclusive one or it will signal a retrenchment from the commitment that Congress has made to allow all Americans a chance to be heard.

And, again, Mr. Chairman, I was delighted to hear your opening statement and your exposition of the history and the facts, because I think its sets the right tone for this hearing. That tone is so important so as to allow us here in the Senate to address these issues in a reasoned, reasonable way as opposed to allowing the passions

and the inflammatory rhetoric to get in the way of our hearing the facts from these witnesses.

The CHAIRMAN. Thank you.

Senator Baucus?

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you, Mr. Chairman. Mr. Chairman, I represent Montana and my people have a very strong interest in this legislation. Basically, as the Senator from Iowa pointed out, to allow farmers to deduct 25 percent of their health insurance premiums.

I must say, Mr. Chairman, that an awful lot of farmers and ranchers in the State of Montana are cash-basis taxpayers. Last March 1st was the deadline for them. It was the day they had to pay their taxes. They were unable to take advantage of the deduction because Congress has not extended it.

Once we pass this extension all farmers will have to file amendments to their returns. That means more accounting fees, that means more hassles, hassles which can be avoided in the future if Congress makes this deduction permanent.

I just believe that the main focus of this hearing is on tax certificates, but the other main focus is on the deduction. It is critical, frankly, to keep our eye on that ball, as the Senator from Iowa said, so we get that part done.

I know, Mr. Chairman, you are concerned about the revenue and so forth, but I think that we must remember that we are here to serve the people and a lot of people want this deduction, and we have got to find a way to make that happen.

Thank you.

The CHAIRMAN. I might indicate what I hope our schedule will be. I would like to have a mark-up on this bill next week. We all share the same view.

Let me say to the panelists today, I am going to ask each of the government witnesses to hold themselves to no more than 10 minutes, and the second panel, which is a big panel, to 5 minutes apiece, because we will have plenty of questions.

I had initially scheduled a third panel at 2:30 this afternoon, but we have got four votes back to back at 2:15. I am hoping we might be able to do it this morning and get it all done, but we can only do it if we are reasonably disciplined in our presentations and our questions.

With that, we will take Mr. William Kennard, who is the General Counsel of the Federal Communications Commission, and Les Samuels, Assistant Secretary for Tax Policy, who has appeared before us on many occasions.

I might say to Mr. Kennard, I appreciate you talking to me at some length. I called him on Saturday morning about 8:00, and whether I got him out of bed or not, I do not know, but I talked at some length with him to get some information. I only told him this morning that I was calling from Oregon, so it was 5:00. So, whatever you suffered, I was up much earlier.

Mr. Kennard?

STATEMENT OF WILLIAM E. KENNARD, GENERAL COUNSEL, FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, DC

Mr. KENNARD. Mr. Chairman, I needed to get up anyway. Thank you.

I have summarized in my written testimony the extensive history of the tax certificate at the FCC and I do not think I could improve on your very learned description of that history today, Mr. Chairman.

I do want to note, I really want to emphasize that the tax certificate is a very successful policy at the FCC today. It has really emerged as the cornerstone of the FCC's policies to try to remedy the severe under-representation of minorities in the broadcast and cable industries.

The tax certificate is successful in two very significant ways. First, it creates incentives for broadcasters to do deals with minority entrepreneurs. It brings minority companies to the table. It puts them in the information loop when stations are being sold and brokers are looking to do deals.

Second, it helps minority entrepreneurs attract the capital necessary to get the deals done. Mr. Chairman, you talked about the conversation with your colleague who is a broadcaster about how he would be willing to sell his station to anyone who had the money.

Well, as we know in this country, access to capital is a unique obstacle for minorities trying to get into businesses of all kinds, particularly broadcasting and cable. What the tax certificate does is it serves as a means for minorities to attract capital to their deals so they can get those deals done.

Significantly, the tax certificate does this in a minimally intrusive way. This is not the heavy hand of government selecting who should get stations and who should not get stations, it gives options to broadcasters to determine whether they should sell their station to a minority or someone else.

What the tax certificate does is it gives the minority broadcaster a hand up, it gets them to the table. It is certainly not a quota or a set aside by any stretch of the word.

Let me address a few of the myths about the tax certificate program that have been circulating recently. First, this is not a program that typically involves very large mega-transactions. The average-sized transaction is really quite small.

Most of the tax certificate transactions have been in the radio context. We have issued at the FCC, since 1978 when the policy was first extended to advance minority ownership in broadcasting, 359 tax certificates, most of them have been in the radio context; 285 for radio deals, 43 for television deals, and 31 for cable television deals.

The average radio deal is $3.5 million. That is the total amount of the transaction, not the amount of the deferral. The 32 television transactions are somewhat larger. They involve an average of about $32 million.

The second myth about this program is that it involves rampant abuse. The FCC carefully analyzes the transactions to ensure that minority principals are truly in control of these deals.

The requesters for a tax certificate submit the transaction documents, the FCC goes through them. Oftentimes we go back to the parties and ask extensive questions to make sure that control does, in fact, reside with the minority entrepreneurs.

Most companies use the program exactly as it was intended. That is, to get a hand up from government to get into the business and to build businesses. The average minority company that acquires a broadcast station through the benefit of a tax certificate holds that station for at least five years, and many for much longer. In fact, about one-third of all broadcast transactions that received tax certificates are still being held by the minority companies.

Senator Hatch, you asked me about possible reforms of the program. I am not here to suggest that the tax certificate program is perfect. There are areas that I think the FCC can and should look at in order to reform the policy, to bring it into line with the way transactions are being done today.

Congress has somewhat limited the FCC's flexibility to reevaluation the program. In our appropriations bills since 1988 there have been restrictions on the Commission's ability to conduct a wholesale reexamination of the tax certificate policy and I urge the committee to allow the FCC flexibility to explore reforming the program in three areas.

Number one. The Commission could extend the holding period. Currently the rules require that the minority company hold the station, broadcast station, or cable system for only 1 year.

Although, as I said earlier, the average holding period is about 5 years and many hold stations for much longer, formally extending the holding period could eliminate some potential for abuse.

Number two. I think we need to recognize that government benefits are a finite resource and they should be distributed widely and on an as-needed basis. Benefits should be maximized for businesses in their start-up phases when attracting capital is most difficult.

The Commission should explore whether there should be limits on the number of times a particular company could use a tax certificate or explore other similar means. For example, there might be a way to explore whether a company should graduate from the program at a certain time or after reaching a certain size so that these benefits can be distributed widely.

Number three. Again, recognizing that these benefits are a finite government resource, we should make sure that the tax deferral benefits are no larger than necessary to achieve the desired result. In other words, I am suggesting that I think it is legitimate to explore whether there should be caps on the total tax deferral benefits in a given transaction.

Let me be very clear about what I am suggesting here. I am not suggesting that the program be changed to exclude very large transactions. It is important that, as the communications industry expands and consolidates, minority companies have the opportunity to participate in all levels, be it the smallest deals or the very largest deals.

But what I am suggesting is that it is legitimate to ask whether at some point in a transaction the tax deferral benefits may be out of proportion to the desired ends of the program. So, in a large

transaction, for example, you could have the amount of the tax deferral decline as a percentage of the total tax deferral.

Let us say you had a $100 million deferral in a very large transaction. You could say the seller could get 100 percent of the first $50 million of the transaction, but that would decline. The next $25 million would be 50 percent, and then 25 percent of the remaining $25 million.

I should also note here that the suggestions that I am making are not meant to foreclose other areas of inquiry, other areas of improvement, and I am not purporting to represent the views of any individual Commissioner today.

But I would like to make clear that the Commission does believe that the tax certificate policy works. It is the cornerstone of the Commission's policies to advance minority ownership in broadcasting and cable, and time and again both the FCC and the Congress have come back to the tax certificate policy because it has worked and they have looked at ways to make it better.

I am urging you today to consider the improvements that I am offering today, and I thank you again for the opportunity to be here. I am, of course, pleased to answer any questions that you may have.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mr. Kennard appears in the appendix.]

The CHAIRMAN. Mr. Secretary?

STATEMENT OF LESLIE B. SAMUELS, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary SAMUELS. Mr. Chairman and members of the committee, I would like to submit my written testimony for the record and summarize it now.

I am pleased to present the testimony today on behalf of the Department of the Treasury concerning the Administration's views on the four provisions of H.R. 831. Section 1 of that bill would extend permanently the 25 percent deduction for health insurance costs of self-employed individuals. The 25 percent deduction is not available for taxable years beginning after December 31, 1993. Consequently, unless Congress acts promptly, self-employed individuals will not be able to claim this deduction for health insurance premiums on their 1994 income tax returns.

As the members of this committee know, the Administration last year proposed the extension of the 25 percent deduction followed by an increase in the deduction to the 100 percent of health insurance premiums.

We continue to believe that allowing a deduction for self-employed individuals more closely conforms their tax treatment to the treatment of other employers with employees. We also believe that the deduction for the self-employed will help to make health insurance more affordable for this segment of the population and will, therefore, contribute to expanded insurance coverage.

The Administration continues to support the permanent extension of the 25 percent deduction and I appreciate the opportunity to state for the record that this issue needs to be dealt with expedi-

tiously. The Treasury Department estimates that almost 3.2 million self-employed individuals would claim the 25 percent deduction on their 1994 tax returns if it were made available to them. Those tax returns are due on April 17, 1995.

If Congress fails to act to extend the 25 percent deduction prior to the due date for income tax returns, millions of taxpayers will be forced to decide whether to file amended income tax returns. Filing amended returns will impose administrative burdens and costs on both taxpayers and the Internal Revenue Service.

The Internal Revenue Service has taken steps to make it easier for taxpayers to claim the deduction if timely Congressional action occurs on this matter. The 1994 Form 1040 includes a line for claiming the self-employed health deduction, with a caution that taxpayers cannot claim the deduction unless the law is changed. Only swift Congressional action can minimize taxpayer uncertainty.

The next issue I would like to address is Section 2 of H.R. 831. This provision would completely repeal Section 1071 of the Internal Revenue Code. Section 1071 generally allows a seller to postpone the recognition of gain realized on the sale or exchange of property if that sale or exchange is certified by the FCC.

Mr. Kennard has described the FCC's Administration of Section 1071. As he noted, Congress delegated to the FCC the responsibilities to determine when a transaction furthers the FCC's ownership and control policies. Thus, the Internal Revenue Service generally accepts as valid any FCC tax certificate that is issued. The Internal Revenue Service does not participate in or oversee the FCC's determinations. The IRS's role, therefore, is generally limited to ensuring that the seller complies with certain of the technical requirements of Section 1071.

The Administration opposes the outright repeal of Section 1071. The Administration is undertaking a comprehensive review of affirmative action programs, including certain aspects of Section 1071. The purpose of this effort is to analyze how effectively the government's resources are being targeted to address the areas of greatest need. In reviewing the operation of Section 1071 we will consider, for example, possible modifications relating to ownership and holding period requirements, as well as caps on the amount of gain eligible for deferral.

Section 3 of H.R. 831 would make the deferral of gain provided by the involuntary conversion rules of Section 1033 inapplicable where replacement property, including stock, is acquired from a related person. We do not oppose this change to Section 1033.

Finally, Section 4 of H.R. 831 would deny the Earned Income Tax Credit, the EITC, to individuals with interest and dividends includable in income in excess of $3,150 per year. The amount of an otherwise available EITC would be reduced if the amount of interest in dividend income exceeds $2,500. The $2,500 threshold and $650 phase-out range would be indexed for inflation.

This provision, without the $650 phase-out range, was included in the President's budget. In developing that proposal we considered a phase-out range as a way of minimizing marginal tax rates for affected taxpayers, but decided that a phase-out would add ad-

ditional computational complexity to the EITC. Nevertheless, we do not oppose the $650 phase-out range contained in H.R. 831.

Mr. Chairman, this concludes my remarks. Thank you for letting me have the opportunity to testify today. I would be pleased to answer any questions that the committee may have.

[The prepared statement of Mr. Samuels appears in the appendix.]

The CHAIRMAN. Thank you. Let me read the list in order. Senator Hatch was here first. So, it will be Hatch, Packwood, Moynihan, Grassley, Moseley-Braun, Baucus, Conrad, Bradley.

Senator Hatch?

Senator HATCH. Thank you. I always thought the Chairman went first.

The CHAIRMAN. Well, we used to have that rule, but I like this idea because it makes people get here before the hearing starts.

Senator HATCH. Well, I am glad to hear that. That is great. Well, I appreciate it.

Let me just ask Mr. Kennard a couple of questions. How many other transactions besides the Viacom transaction would be precluded from receiving the minority tax certificate because of the effective date of H.R. 831?

Mr. KENNARD. Senator, approximately 17 tax certificate were pending at the time that the House announced that they might have a retroactive appeal of Section 1071. Approximately 17.

Senator HATCH. 17 would be affected.

Mr. KENNARD. Yes.

Senator HATCH. How many FCC tax certificates have been granted under existing policy, did you say 350?

Mr. KENNARD. 359. Yes.

Senator HATCH. 359.

Mr. KENNARD. That's under the minority tax certificate program; tax certificates are issued in other contexts as well.

Senator HATCH. All right. But since the FCC's policy on tax certificates was expanded to include the minority ownership goals, have most of the tax certificate issued by the FCC not been in that category?

Mr. KENNARD. That is correct.

Senator HATCH. All right. You consider the minority tax certificate program a success.

Mr. KENNARD. Yes.

Senator HATCH. You said so. And everybody there feels pretty much the same?

Mr. KENNARD. Yes.

Senator HATCH. And the Administration seems to think so.

Mr. KENNARD. As far as I know, that is right.

Senator HATCH. Does the FCC have some specific percentage of minority ownership of broadcast and cable facilities in mind as a goal?

Mr. KENNARD. No, it does not, Senator. As was pointed out earlier, when the tax certificate was extended to the minority ownership context, less than 1 percent of broadcast stations nationwide were owned by minorities. It is still a small percentage.

The Department of Commerce has reported that today only 2.9 percent of the total broadcast stations are owned by minorities. We

have not sought out to establish this program as a quota or to determine that there should be a set amount of stations that go to minorities.

Rather, we recognize that there still is severe under representation of minorities in the industry and as long as that situation persists we need to continue to find ways to remedy it.

Senator HATCH. I was interested in your three suggestions as to how you might be able to modify 1071.

But let me ask Mr. Samuels a couple of questions. Viacom has publicly stated that the sale agreement will be terminated if the repeal of Section 1071 is applied retroactively. What would the revenue impact be of having the gain on the sale deferred versus no sale at all?

Secretary SAMUELS. Senator Hatch, in responding to your question I would like to make just one observation. We are not in a position to make comments on a specific taxpayer, so if it is acceptable I would like to talk more generally about it.

Senator HATCH. But would you lose any taxes if that sale goes through or does not go through?

Secretary SAMUELS. Our revenue estimate that we have prepared takes account of all information that we have available to us, so I cannot comment on what that particular taxpayer may or may not do.

Senator HATCH. Well, let me move on from that question then. Some of the proponents of the minority tax certificate program have stated that if the benefits of this program are eliminated by this legislation, the owners of broadcast and cable facilities will simply find another tax-deferred method of selling, thus eliminating any hope of immediate revenue to the Treasury. How many broadcast and cable facilities are sold in taxable transactions, do you have any idea about that?

Secretary SAMUELS.

Senator Hatch, I do not have the specific numbers. What we have done is taken into account in the revenue estimates behavioral effects which would include a shift from taxable to non-taxable transactions.

Senator HATCH. Well, I guess there are plenty of other ways to structure a deal to defer taxes under our current tax law.

Secretary SAMUELS. Senator, there are. I would mention, though, that in a transaction where there is tax deferral there is a tension between the buyer and seller. In a tax-deferred transaction, for example a tax-free reorganization, the buyer would not receive a so-called "step up" in basis, but rather would inherit the seller's tax attributes.

So there are tensions between the buyer and seller from a tax perspective in deciding whether a transaction will be tax-free or taxable. And, in addition, if a seller decides to engage in a tax-free reorganization, the seller will ultimately wind up with stock or securities of the buyer, and if the seller wants cash, that, of course, would not be an acceptable form of consideration. So there are numerous considerations that are taken into account in structuring a transaction.

Senator HATCH. Yes. I think almost everybody here certainly wants the 25 percent small business exemption kept; certainly I do.

On the other hand, I want to see that there is justice done with regard to these matters.

One last question. Does the Treasury agree with the Joint Committee on Taxation's estimate of the revenue impact of repeal of Section 1071?

Secretary SAMUELS. Senator Hatch, the Treasury has estimated the complete repeal and our estimate is somewhat higher than the Joint Committee on Taxation.

Senator HATCH. All right.

The CHAIRMAN. Mr. Kennard, the Metro Broadcasting versus the FCC case is absolutely pinioned on the FCC's finding of the necessity for the diversity in broadcasting and that there is a tremendous difference in the way minorities and non-minorities program. Is that correct?

Mr. KENNARD. Yes, Senator.

The CHAIRMAN. And the court therefore said, we do not have to make any finding of discrimination. They never even got to that. As a matter of fact, I think you had no finding of discrimination. You had a finding of program diversity but no finding of discrimination in the sale of properties.

Mr. KENNARD. That is correct.

The CHAIRMAN. The reason I ask that is I sensed your statement today, and especially your closing statement, was a little bit different than the pinion of the Metro case. I sense you are saying, policy ought to be to use these tax certificates or other policies to make sure that minorities own broadcasting stations for the sake of having minorities own them rather than a difference or a diversity in programming.

Mr. KENNARD. Well, Senator, diversity is certainly the ultimate goal. What I was suggesting in my comments earlier is that in order to achieve that diversity goal we need to ensure that minorities participate at all levels in the industry so that there is not a danger that minorities become marginalized in the business and only get the very smallest stations or the less attractive stations. What the tax certificate does is it creates a powerful incentive for the sale of stations to minorities at all levels of the broadcast and cable businesses.

The CHAIRMAN. Yes. But I think you are missing the thrust of my question. One policy is to say we want program diversity. The only way we are going to get it is with minority ownership because whites just do not program that way. Therefore, we will have a policy that will favor minorities in order for them to own stations in order to get the diversity of programming that we want because that is good for the listening public.

Mr. KENNARD. Yes.

The CHAIRMAN. Two, without ever getting to the program diversity or anything else, are you suggesting the policy ought to be, we want to have a policy that will favor the sale of stations to minorities simply because minorities ought to own more stations?

Mr. KENNARD. No. The underlying premise of the policy is to advance diversity. As you point out, the Supreme Court in the Metro case made very compelling findings that diversity of ownership results in diversity of programming. This is important, not just to ensure that minority audiences are exposed to minority broadcasters,

but all Americans are exposed to diverse programming by minorities and others.

The CHAIRMAN. There was no evidence of discrimination in the sale of broadcast properties. The statement I had from the one person that says, I will sell it to the highest bidder makes perfectly good business sense. Why would you not sell it to the highest bidder, no matter who it was?

I talked with two of the minority witnesses who will appear here later and they both kind of echoed your statement. The great problem is access to capital. They said, if we have got the capital we can buy the stations. But minorities have historically had a difficult time on access to capital.

Let me ask you this. If the issue is not diversity of programming, should the FCC still support a policy of awarding stations to minorities for the purpose of more minorities owning stations, even though there is no evidence at all of discrimination in the sale of broadcast properties?

Mr. KENNARD. Well, my personal view, Senator, is that there is a compelling justification to ensure that there is diversity of ownership, irrespective of programming. That is my personal view. It is my view that the spectrum is a finite resource and it should benefit all Americans, and that the government has an obligation to make sure that, in licensing spectrum, all Americans are able to have opportunities to use it.

The CHAIRMAN. But the problem with minorities being able to use it now is capital.

Mr. KENNARD. That is right.

The CHAIRMAN. If they had capital they could buy. The fundamental question I am asking is this—and it does not relate now just to broadcast properties, it can be to any of your Personal Communication licenses, or anything else—should we have a policy that favors minorities even where there is no evidence of discrimination because we want minorities to own more properties. In other words, are we reaching the place where we are going to have minority-based preferences even where there is no showing of discrimination at all?

Mr. KENNARD. Well, Senator, it is a complex problem, but I think that the reason we have under representation of minorities in broadcasting is because there is discrimination in the capital markets.

Congress has made findings in many other contexts that minorities have difficulty accessing capital to the same extent as other people, and so in order to get to the diversity goal you have to remedy the access to capital problem, which is a function of, unfortunately, discrimination in lending and accessing capital.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Just to pursue your question for a moment. I would ask Mr. Kennard, program diversity, what exactly does that mean? I am from New York. I was raised in New York City. There were radio stations all across the dial.

One was Make Believe Ballroom, and the other was W-QXR, which played Brahms most of the time, and the other was an all news station. What is diversity in that sense? I mean, I thought stations try to find, what do they say, a niche, a group that will

listen to this kind of music, or that kind of news, or the baseball game.

Mr. KENNARD. Well, diversity obviously is different things to different people. But in this context, fundamentally, what it means to me——

Senator MOYNIHAN. If it is different things to different people then it is a problem of a uniform standard that is to be applied, is it not?

Mr. KENNARD. I do not think so, because what the courts have found in this context is that they have relied on a wealth of empirical research that shows that when you have minority ownership of broadcast stations, those stations do direct more programming to minority audiences and that programming is different.

Senator MOYNIHAN. Different how? I am just asking a question.

Mr. KENNARD. Let me give you an anecdotal story about this. Yesterday in the Style section of the Washington Post there was an article about a woman by the name of Cathy Hughes, an African American woman, who was able to acquire a small AM station in Washington, DC through the benefit of one of our FCC policies called the Distress Sale Policy. She turned that station into a news/talk format directed to the black community. Since then she has been able to use the tax certificate policy in order to buy other stations.

There is no question but that the programming on that station is different because it is owned by a black woman. It has enriched the airways because it serves as a unique voice for the black community in this city. In my view, that is diversity, and that is the value of this program.

Senator MOYNIHAN. Again, relating to a youth in New York City, there would be a station that would play Irish music, German music, Polish music. There are still. Would they be eligible?

Mr. KENNARD. Well, not under our policies. In accordance with the Metro case, in order to sustain a program like we have, we rely on minority ownership and certain defined classes of minorities. We have not looked to ethnic programming generally, no.

Senator MOYNIHAN. How do you define majority? If there is a minority, why, it must follow there is a majority.

Mr. KENNARD. Well, we follow the OMB's classifications on minority groups that are reported for Federal statistics and program Administration purposes. Those are American Indian or Alaskan native, African Americans, Asians, Pacific Islanders, and Hispanics.

Senator MOYNIHAN. Pacific Islanders. In one of the lists recently I came across natives of Curabati and Tubelo.

Mr. KENNARD. I am not familiar with those groups.

Senator MOYNIHAN. Well, you had better catch up if you are going to stay general counsel there. They might show up 1 day.

Mr. KENNARD. I beg your pardon?

Senator MOYNIHAN. I mean, they might show up 1 day.

Mr. KENNARD. They may well, and at that time I am sure we will address the issue, Senator.

Senator MOYNIHAN. But how will you be sure that they are really from Tubelo?

Mr. KENNARD. Well——

Senator MOYNIHAN. I just mean to suggest there are problems in all this, are there not?

Mr. KENNARD. Yes.

Senator MOYNIHAN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. Mr. Kennard, there are some who are making charges that the FCC has not had a chance, nor has wanted, to examine whether or not this tax certificate program has made sure that all of the minority transactions that have been made have been legitimate. It is my understanding that you have been prohibited from doing a study on the FCC tax credit program.

Is this correct? If so, who has been the primary opponent of reviewing this program, and why? And I ask this question in the context of the fact that you say the program works but in the final analysis, how do you know it works if you have not been able to study it? Now, maybe my information is wrong, but I have asked my question.

Mr. KENNARD. Well, actually, you have two questions there. Let me answer the first one, first. The Commission was restricted in its ability to reexamine or change the tax certificate policy beginning in 1988.

In that year Congress decided that they did not want any changes in the program. There had been efforts at the FCC to reexamine or repeal it and Congress, recognizing the value of the program, determined that they wanted to make sure that it stayed in place.

In terms of how rigorous our review of the tax certificate program has been over the past, what I am suggesting today is that we should have the flexibility to look at some areas of the program and make sure that our Administration of the program is being done in a professional way. As I suggested earlier, there are some areas that I think need reform.

Senator GRASSLEY. I think the Chairman made the point, or somebody did, if you have capital you can get into this business. So, consequently, because people do not have capital, that is why we have the credit, to encourage the capital and to, in this specific instance, allow minorities to get in.

But assuming you have the ability to get capital, and if we got limited government resources that we want to help those with the most need, why should the minority aspect of the program not be modified to be based on the economically disadvantaged, I will call them, as opposed to just because of minority status?

Mr. KENNARD. Well, as I had suggested earlier, Senator, one of the areas I think we might look at is ensuring that the program is limited to assisting businesses in their start-up phases, entry-level opportunities.

I think that the program has been successful in promoting minority ownership and most of the beneficiaries of the program, the minority companies, have been small, have been start-up businesses, but we should make sure that that is the case.

In terms of the suggestion in your question that perhaps this be extended to other small businesses, there has not been a suggestion that small businesses generally have difficulty getting into the

broadcast business. In fact, the broadcast business is primarily a business of small businesses, particularly in radio.

So I think that it is appropriate to limit the program at this time to remedying the principal problem that we have perceived, and that is underrepresentation of minorities in the business.

Senator GRASSLEY. All right. The point I was trying to make though, was not just small business, it was a class that we make special provisions for in a lot of public policy, as we make special provisions for minority groups, the economically disadvantaged, as opposed to specifically minority, based upon the proposition that we are going to use the resources of our Treasury to help those who have the most need and not necessarily just because they are in a minority status, based on the proposition also that some minorities, as well as non-minorities, have capital and can get into the business.

Mr. KENNARD. It might be an area worth exploring, Senator.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much.

Mr. Kennard, Senator Moynihan and one of the other questioners touched on the notion of the difference between program diversity versus ownership diversity. That is to say, what difference does it make that there is a minority owner in terms of the content of the programming?

Diversity of voice is one of the fundamental statutory directives that comes out of the law for the FCC. Is that correct?

Mr. KENNARD. That is correct, Senator.

Senator MOSELEY-BRAUN. And have you examined or analyzed the statutory basis or the legislative history behind the statutory requirement pertaining to diversity of voice?

Mr. KENNARD. Well, diversity of voices is one of the fundamental principles in the Communications Act. In fact, when 1071 was enacted in 1943 it was enacted in connection with rules adopted by the FCC to limit the number of stations that any single entity could own. It had nothing to do with minority ownership. The premise of those rules was that increased diversity of ownership would result in diversity of programming. So, that is a concept that is in our jurisprudence and in our act in many contexts, not just in the minority ownership context.

Senator MOSELEY-BRAUN. I guess the question, to go one step further though, is was there anything in the legislative history that suggested there was some value to diversity that would be lost to the whole in its absence? What is the value of having a multitude of voices and a multitude of opinions in terms of the airways, and is that reflected in the legislative history of this section?

Mr. KENNARD. It is not reflected in the legislative history of Section 1071, no.

Senator MOSELEY-BRAUN. It is reflected in the legislative history of the larger, overall statute?

Mr. KENNARD. That is what I am suggesting, yes.

Senator MOSELEY-BRAUN. Would you speak to that for a moment?

Mr. KENNARD. Yes. Well, as I was saying, we have many rules at the FCC which limit the number of broadcast stations that any single entity can own. Again, the whole premise of that is, in-

creased diversity of ownership results in diverse programming. The courts have upheld this notion many times.

Senator MOSELEY-BRAUN. I guess I am trying to get to, what is the point? I mean, what is the point of having diversity; what does it do, what does it serve the larger community to have a multitude of views and voices available to be heard in the airways?

Mr. KENNARD. Well, in a democracy you certainly want to ensure that the public has access to lots of different viewpoints.

Senator MOSELEY-BRAUN. Thank you very much.

With regard to the issue of capital, and one of the other members raised the issue of access to capital and suggested that Section 1071 gives a boost up to allow minorities access to capital in order to engage in these deals.

Yet, in some of my discussions with individuals who are involved with this, what I got was that it was not only a matter of access to capital, it was also a matter that this section allowed access to information regarding the industry and access to information about the potential properties that might be available for sale, that it got them into the loop so they could participate to begin with in this industry, in this area of endeavor. Have you had a chance to look at that aspect of the operation of this section?

Mr. KENNARD. Yes, we have, Senator. Over the years the Commission has noted that one of the primary benefits of Section 1071 is that it gives broadcasters and cable owners a compelling reason to do business with minority entrepreneurs.

It ensures that when these lucrative and attractive properties come on the market, that minority buyers are contacted. There is, obviously, in this business a network of brokers and people who make their business selling stations. What Section 1071 does is it ensures that they have a reason to do business with minorities.

Senator MOSELEY-BRAUN. One of the earlier questioners asked the question regarding the number or the percent of tax-free transactions that happen in the absence of this section. I think the question was put to Secretary Samuels, but he was constrained to answer.

Would you have some response to that? What did the history that the Commission has seen with regard to transactions that take place with no tax consequences, that is to say, no immediate revenue to the Treasury from the transaction?

Mr. KENNARD. Well, Section 1071 is not the only way that a broadcast or cable property can be sold tax-free. We compiled a list, just kind of anecdotally, of some recent transactions involving very, very large broadcast and cable companies that were sold and many of them were done in stock-for-stock swaps or tax-free exchanges. So, in a situation where someone needs a tax deferral, there are ways other than Section 1071 to do it.

Unfortunately, in the minority context, Section 1071 is the only way that we have a kind of powerful incentive to make sure that deals are done with minority buyers.

Senator MOSELEY-BRAUN. And so the effect of a repeal would be simply to cut off the diversity of voices that minority owners bring to the airways.

Mr. KENNARD. That is right. If someone is looking to sell a property and they need to do it tax-free, without 1071 they may well

find a way to do it tax-free, but the benefits of minority ownership would be lost.

Senator MOSELEY-BRAUN. Thank you.

The CHAIRMAN. Senator Dole and then Senator Conrad.*

Senator DOLE. Throughout the years that the FCC has modified the tax certificate programs, has Treasury ever been consulted; is there any consultation back and forth between Treasury and the FCC? As they modified the tax certificate program, has there been any consultation with Treasury?

Secretary SAMUELS. Senator Dole, I am not aware of any. The Treasury and the IRS are not involved in the policy aspects of this program.

Senator DOLE. Are there other entities that are out making tax policy, other agencies in the government, like the FCC?

Secretary SAMUELS. Senator Dole, there are some other provisions of the Internal Revenue Code where decisions are made that would affect the availability of tax benefits. For example, the Presidential designation of combat zones carries with it certain tax benefits for those who are in the combat zones.

Senator BRADLEY. What was that again?

Senator DOLE. If you get shot at you get a bigger deduction.

Secretary SAMUELS. You can exclude your combat pay and you can file your return after the effective date. There are Presidentially-declared disaster areas which give taxpayers certain additional rights that they would not otherwise have. The Environmental Protection Administration can certify with respect to certain pollution——

Senator DOLE. You might just give us a list of those.

[The information appears in the appendix at page 110.]

Senator DOLE. I had not thought of the first one.

Senator MOYNIHAN. Did you get any?

Senator DOLE. I do not know. You ought to get it for being here. [Laughter.]

Senator BRADLEY. I think it ought to be retroactive.

Senator DOLE. I have heard everybody talk about everything, and I do not disagree with everything that has been said about different policies, diversity. But how do we explain to the taxpayers that somebody is going to walk off with $460 million, maybe $600 million here. It is going to be a deferred gain, deferred taxes? How do you explain that, Mr. Kennard? Somebody is making a lot of money, right?

Mr. KENNARD. Presumably so.

Senator DOLE. You do not know who that is?

Mr. KENNARD. Well, as I suggested earlier, Senator, I think that it is appropriate to look at whether the amount of the deferral is in proportion to the desired benefit, and I suggested some ways to——

Senator DOLE. Who calculates that, do you calculate that at the FCC?

Mr. KENNARD. No. You asked Mr. Samuels earlier if there is coordination between the IRS and the FCC. There is no formal coordination. Last year we proposed in a Notice of Proposed Rule

* Prepared statement of Senator Conrad appears in the appendix.

Making that we do set up a working group between the IRS and the FCC to look at the tax certificate policy so that there is more coordination between the two agencies.

Senator DOLE. But it seems to me that the self-employed tax deduction which we all support, we would have to find a way to pay for it and maybe Treasury has got a better way to pay for it. We are talking about cutting all the programs from A-Z with the exception of Social Security.

And then we pick up the papers—maybe the papers are not accurate—that somebody is going to be able to defer a gain in the range of $1.1-1.6 billion. I do not know how to explain that. How do you explain it when people write to you, do you have a little form letter you send out to tell people?

Mr. KENNARD. Well, I have not been asked, Senator. But my explanation would be something along the lines that, under current law we are not permitted to look into those issues. That is why we are here, to ask the Congress for flexibility to look at some of these issues so that we can determine whether a huge tax deferral is appropriate in a given transaction, or in any transaction.

Senator DOLE. I mean, you would support repealing the appropriation rider that has been added to appropriations bills every year?

Mr. KENNARD. I think it would be appropriate to modify it so that the FCC has more flexibility to look at this program, yes.

Senator DOLE. But I had a call from Quincy Jones last week. Thinking, of course, he wanted to sign up in my 1996 effort, I immediately returned the call. [Laughter.]

Senator DOLE. But it was on this issue, as you might guess. But I want to follow-up on what Senator Packwood and Senator Moynihan were talking about, that is, program diversity. That is the objective of having a minority tax certificate. But you have clearly used the tax certificate on the PCS side, too, where there is no medium or it is in the business of providing diversified programming. Can you comment on that? I mean, it has been used in both cases.

Mr. KENNARD. Yes. Well, the tax certificate is used, as I mentioned earlier, outside the minority ownership context. In PCS it is used in a couple of ways. One, it is used to clear certain frequencies of incumbent microwave users.

What that means is, in order to roll out Personal Communication Service, or PCS, which is an exciting new wireless service, the FCC was faced with the problem of how to deal with incumbent users of that PCS spectrum. So we extended the tax certificate to allow a grant of tax certificates to microwave users who agree to relocate to other bands and to replace their equipment.

Senator DOLE. Now, for FCC to receive a minority tax certificate, the minority principles must demonstrate that they exercise control to the buyer. What kind of standards or tests does the FCC conduct in order to examine this issue, whether or not they actually have control of the operations? What tests do you use?

Mr. KENNARD. Well, the Commission looks at a number of things. Fundamentally, the bottom line is that the minority entrepreneur has to show that he or she has control of the enterprise, both legal control and actual control. There are also equity requirements.

Senator DOLE. Is there some regulation or something you can put in the record to show what tests are used?

Mr. KENNARD. Yes. There are policy statements which have stated what the test is, and it has been refined over the years through the various cases.

Senator DOLE. Could we have that furnished for the record?

Mr. KENNARD. Most certainly, yes.

[The information appears in the appendix at page 106.]

Senator DOLE. So if we acted to repeal the appropriations riders tying the FCC's hands, do you think that would be all right?

Mr. KENNARD. Yes. That is what I am suggesting, Senator. We need some flexibility to look at this program.

Senator DOLE. Would repeal not give you that flexibility?

Mr. KENNARD. Not repeal of 1071 altogether, but repeal of the appropriations rider, yes.

Senator DOLE. Because after we address this issue we will be looking at another issue called pioneer preferences, which is written into the GATT, where somebody else is going to make another $500 million because of a bid discount.

I mean, it seems to me when we are cutting all of these Federal programs, as I said earlier, we should take a careful look. Even though I sympathize with the goals, I cannot sympathize with somebody walking off with half a billion dollars in the transaction. I do not see how that can be justified by this Administration. Treasury supports this, is that correct, Mr. Samuels?

Secretary SAMUELS. Senator Dole, we oppose the complete repeal of 1071. As Mr. Kennard has said, there are issues to look at. We are addressing in the Administration an overall review of these affirmative action programs in Section 1071. The minority part of Section 1071 is in that program.

Senator DOLE. Right. But we have to move rather quickly on this, as you indicated in your statement——

Secretary SAMUELS. Yes.

Senator DOLE [continuing]. If we are going to get it done. What is your goal?

The CHAIRMAN. I would like to mark-up next week.

Senator DOLE. So hopefully we can talk about a partial repeal. I do not know what that means. I assume you have some specific suggestions on how you would change Section 1071.

May I put my statement in the record?

The CHAIRMAN. Without objection.

[The prepared statement of Senator Dole appears in the appendix.]

The CHAIRMAN. Senator Conrad.

Senator CONRAD. I thank the Chairman.

Mr. Kennard, what is the percentage of minority ownership that is required to qualify for the certificate program?

Mr. KENNARD. The FCC requires that there be at least 20 percent equity in a transaction and there must be control. So, control has to be represented by more than 50 percent of the voting stock, or in a partnership, control as represented in the partnership agreement.

Senator CONRAD. Does the FCC require continuing minority ownership as a condition?

Mr. KENNARD. There is currently a 1-year holding period. That is, a minority company that acquires a station through the benefit of the tax certificate must hold that station for 1 year.

I suggested earlier in my testimony that that is one area we might look at to extend it. In some of our other minority ownership programs we have longer holding periods, and I think the Commission generally—although I do not speak for all Commissioners on this—favors a longer than 1-year holding period.

Senator CONRAD. I am told, in information that was provided by the FCC, that 71 percent of the stations that used a certificate were no longer held by the original minority purchaser at the close of 1992. Do you know if that is accurate?

Mr. KENNARD. I am not sure how that statistic was derived, Senator, no.

Senator CONRAD. Could you tell me, from your observation in being familiar with this program—as I understand it, FCC has issued over 300 such tax certificates—what your view is of whether or not minorities remain in control of most of those stations, or has this been a transitory thing?

Mr. KENNARD. Well, as I mentioned earlier, we determined that the average holding period is about five years in a tax certificate transaction, and many for much longer. In the broadcasting area there is a fairly high turnover of properties just generally outside the minority context; about 10–15 percent of stations turn over every year. So, this is not a business where, typically, people hold stations in perpetuity.

Senator CONRAD. Mr. Samuels, if I might ask you, with respect to the Earned Income Tax part of this, what is the revenue loss or revenue gain from the EITC changes?

Secretary SAMUELS. The Joint Committee estimate for 1995 through the year 2000 that they prepared for the House bill was $1,260,000.

Senator CONRAD. And the Administration does not oppose the Earned Income Tax credit changes that are proposed here, is that correct?

Secretary SAMUELS. That is correct, Senator Conrad.

Senator CONRAD. Can I ask you, just very quickly, with respect to an alternative that has been offered with respect to people who choose to expatriate, I think you referred to them as economic Benedict Arnolds, wealthy Americans who choose to expatriate in order to avoid U.S. taxes. Could you explain what the abuse is that is occurring there?

Secretary SAMUELS. Senator Conrad, the abuse that we are concerned about relates to a U.S. citizen renouncing their citizenship, which means they would leave the United States and at the time they leave the United States they would no longer be subject to U.S. income tax on their income and gains.

There has been a provision in the Internal Revenue Code since 1966 which would tax them on certain U.S.-sourced gains that they would realize for a period of 10 years after their date of their renunciation of their citizenship, but we have found that, in practice, that rule is very easy to avoid.

Senator CONRAD. Can you tell us how many people we are talking about? These are wealthy Americans who made their money

here and then they renounce their citizenship in order to avoid taxes here. How many people are we talking about, do you have any idea?

Secretary SAMUELS. Senator Conrad, we anticipate that our proposal would affect about two dozen individuals.

Senator CONRAD. And how much money would be gained from affecting two dozen? So, we are talking about 24 people.

Secretary SAMUELS. Senator Conrad, our revenue estimate is that it would be $2.2 billion over the five-year budget period.

Senator CONRAD. $2.2 billion from 24 people?

Secretary SAMUELS. Yes. Yes, sir.

Senator CONRAD. Can we get a list of their names? [Laughter.]

Secretary SAMUELS. Senator Conrad, the revenue estimate also includes those people who decide not to leave in order to escape their tax obligations, so they will still be here and we will continue to collect income tax from them.

Senator CONRAD. I really find that extraordinary that a handful of people, that kind of tax incidence. Thank you very much.

I thank the Chair.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman. Mr. Samuels, do you think the Internal Revenue Service should play a role in administering tax certificate programs?

Secretary SAMUELS. Senator Bradley, I think if the committee decides to revise Section 1071, that going forward there should be better coordination between the Internal Revenue Service and the FCC, and that it seems to us it would be appropriate that their role be expanded.

Senator BRADLEY. Do you think it is appropriate that the Internal Revenue Service would issue regulations on administering the 1071 program?

Secretary SAMUELS. Yes. I think that if there are changes we would obviously look at the changes and issue regulations. Under current law, the Internal Revenue Service is not involved in the FCC policies. The FCC makes their policy and we look, really, at the technical compliance with certain of the provisions of Section 1071.

Senator BRADLEY. Mr. Kennard, if I could, as I understand what you said in your opening statement—and I am not sure all of the Senators were here for your opening statement—you were recommending several specific changes in the 1071 program. You were recommending that the holding period for a license be extended from 1 year to 3 years?

Mr. KENNARD. I did not give a specific number.

Senator BRADLEY. But would 5 years or 10 years be——

Mr. KENNARD. In other contexts we have imposed a five-year holding period. Previously there was a 3-year holding period in broadcasting that seemed to work fairly well.

Senator BRADLEY. You said that you would like to limit individual taxpayers' use of the program. How would you do that?

Mr. KENNARD. Well, I think it would be most appropriate to determine in a context of a rule making how best to do it, but some of the ideas I was suggesting were to limit an individual's ability to use the tax certificate to a certain number of times, or perhaps

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to limit the size of the company that could use it, so that at some point you would graduate from the program.

Senator BRADLEY. So that flows out of a view that the program, as it exists, is itself not flawed, but if it leads to a problem of scale, then that is remedied by simply limiting the size of the company that can take advantage of it. Is that the point?

Mr. KENNARD. Yes, in part.

Senator BRADLEY. All right. Would you cap the total amount of benefits that would flow into a program?

Mr. KENNARD. To the program overall?

Senator BRADLEY. Yes.

Mr. KENNARD. I think we might want to discuss that. I am not sure how we could administer that.

Senator BRADLEY. All right.

Mr. KENNARD. Because it is hard to anticipate what types of transactions are coming down.

Senator BRADLEY. Would you cap the specific amount per transaction?

Mr. KENNARD. Yes. I think there could be limits on the amount of the transaction.

Senator BRADLEY. Do you have an amount in mind?

Mr. KENNARD. I am not prepared now to suggest a number, no. I think we need to do more studies.

Senator BRADLEY. The House had $50 million in an amendment. Is that picked out of the air?

Mr. KENNARD. I believe it was. The problem that I have with the——

Senator MOYNIHAN. Airwaves.

Senator BRADLEY. Out of the airwaves. Thank you very much.

Mr. KENNARD. The problem I had with the House approach is that it did not recognize that there may be situations where you have larger transactions and the cap should be expressed as a percentage of the total deferral.

Senator BRADLEY. As I understand your justification for the program, it is to ensure that there would be program diversity. Is that correct?

Mr. KENNARD. Yes, sir.

Senator BRADLEY. You offered an earlier view that was slightly different than that, but the record should reflect that the principal objective is program diversity.

Mr. KENNARD. That is correct, Senator.

Senator BRADLEY. Which is obtained in one way by diversity of ownership.

Mr. KENNARD. Yes.

Senator BRADLEY. But the program diversity is the prime objective.

Mr. KENNARD. Yes. In the mass media context.

Senator BRADLEY. And diversity of ownership is a means to that end.

Mr. KENNARD. Yes.

Senator BRADLEY. And the end is the important thing.

Mr. KENNARD. Correct.

Senator BRADLEY. All right.

Now, Mr. Samuels, you are a business man, you are a tax lawyer. You are advising companies on how to avoid tax. I have been here for 16 years and there is no company that comes in here and says, Senator, I want to pay more tax; they want to pay less tax and they are going to utilize whatever they can to pay less tax. It is our objective to try to collect taxes fairly from people who owe it. That is how you see your responsibility now.

In your previous life, if you were a tax lawyer, and somebody said to you, well, how can we avoid paying tax in any kind of transaction, you would say what? Well, you could do a swap.

What else would you advise them they could do to avoid paying any tax on a transaction? You can leave the country, renounce your citizenship. But, of course, you would not want to advise them of that because you would only be a lawyer to loyal Americans, so you would not want to give that advice.

So what would you recommend that they do?

Secretary SAMUELS. Well, Senator, in the typical kind of business transaction involving these type of business properties I think the type of advice that you would think about giving relates to tax-free reorganizations, stock-for-stock swaps, or various forms of them. But that would be, I think, the principal provision of the Internal Revenue Code that you would look at, apart from Section 1071, if it involved——

Senator BRADLEY. So there are a range of other options, right? If 1071 is repealed, those individuals who might use 1071 to defer would simply have available to them other options to achieve the same objective. So the question is, if our objective is to get more revenue, it might be frustrated, is that correct?

Secretary SAMUELS. Senator Bradley, we, in our revenue estimate, took into account the behavioral effects which would include people switching to other forms of tax-free transactions.

The CHAIRMAN. Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you very much.

Mr. Samuels, you support the 25 percent deduction on health care. How much is that supposed to cost over five years, if you have it off the top of your head?

Secretary SAMUELS. Yes. Senator Nickles, this is the Joint Committee estimate that was prepared for the House bill, which would start for last year and extend it indefinitely, for the 5-year, or really a 6-year budget period, is $2,925,000. So it is almost $3 billion.

Senator NICKLES. Almost $3 billion.

Secretary SAMUELS. Right.

Senator NICKLES. And the EITC changes are about $1.2 billion?

Secretary SAMUELS. Correct.

Senator NICKLES. How much is the 1071?

Secretary SAMUELS. That is about $1.4 billion. Then there is the Section 1033 modification which is roughly $300 million.

Senator NICKLES. All right. Now, I will confess, I was not aware of 1071 until the Viacom deal. We have had 350 certificates since 1978, something like that. Is that correct?

Mr. KENNARD. 359, Senator.

Senator NICKLES. 359. What is the average value, I guess, of the tax deferral on those 359, do you have that figure?

Mr. KENNARD. Yes, 285. We do not have the tax deferral, we know the average size of the transaction. Taxpayers are not required to disclose to us, when they request a certificate, what the amount of the deferral will be.

Senator NICKLES. Does Treasury have any idea what the amount of the deferral is, i.e., the Viacom deal has headlines, it is a $400 million tax break. Do you have those figures for other deals?

Secretary SAMUELS. Senator Nickles, when we did our revenue estimates we looked at a package of information. I do not have any specific averages to give you, but we took the information that we had into account in preparing our revenue estimates.

Senator NICKLES. You mentioned over the next five years you are looking at $1.4 billion would be gained if this certificate was repealed?

Secretary SAMUELS. Senator Nickles, that was the Joint Committee estimate. The Treasury estimate is slightly higher.

Senator NICKLES. Like $1.5 billion?

Secretary SAMUELS. Let me just——

Senator NICKLES. I am just looking for rough figures.

Secretary SAMUELS. It is $1.7 billion.

Senator NICKLES. $1.7 billion. I have told my friend and colleague, Senator Moseley-Braun, that I would listen and I want to listen, but I ran into this article that was in the Washington Post that talked about, "NBC to forgive loan to firm owned by Ron Brown."

I do not know if this is a typical deal or not, but this was a 1988 loan, I guess, when NBC sold its radio station to James Kelly, who is the husband of former Mayor Sharon Pratt Kelly, and Ron Brown, and a couple of other associates. Now, I guess, this was about a $10 million loan. Do you have any idea what the value of the tax deferral was in this particular project?

Mr. KENNARD. I do not, Senator, no.

Senator NICKLES. Could you get us some information on that?

Mr. KENNARD. I will endeavor to do that, yes.

Senator NICKLES. I appreciate it.

I would like to learn more about this, because it really looks to me—and I am going to try and be open-minded—like a subsidy for a handful of millionaires, which may be questionable.

Also, Senator Conrad mentioned the question that it may not be achieving its goal of diversity if the turnover rate is so high. Someone had mentioned to me that 70 percent of the radio stations that were purchased under this program for minorities were sold within three and a half years. Is that correct?

Mr. KENNARD. That is not consistent with our data, Senator. We have determined that the average holding period is about 5 years.

Senator NICKLES. I heard you say that. I said 70 percent of the radio stations would be sold within three and a half years. You have averages that would come out to five. I am just wondering, if the turnover is that high, are there deals consummated where there would be an automatic turnover within a certain period of time?

Mr. KENNARD. Not necessarily, no.

Senator NICKLES. Are they prohibited?

Mr. KENNARD. As I mentioned earlier, there is a one-year holding period. I am suggesting that we explore extending that holding period.

I did want to respond to one of the questions that you asked earlier, that is, is this program benefitting just a handful of people. The data that we have compiled from all of the companies that have used tax certificate as buyers suggests that it really is a fairly diverse group.

There are a handful of people who have used it multiple times, and, as I suggested, perhaps we should look at that. But, overall, the tax certificate has benefitted a fairly broad group of people.

Senator NICKLES. Well, when you mentioned fairly broad, you are talking about 359 certificates. Mr. Samuels mentioned just in the next 5 years we are talking about $1.7 billion. I do not know how many individuals might be in each one of these deals, but presumably a few people. You are talking about millions of dollars of value. How many are you estimating would happen in the next five years? Maybe that would be the way of stating it.

Mr. KENNARD. I cannot predict how many tax certificate requests we would get.

Senator NICKLES. $1.4 to $1.7 billion tax benefit, tax deferral over the next 5 years, it seems to me like it is benefitting relatively few people. You have only had 359 in the first 16 years.

I thank the Chairman. If you could provide that for us, that would be helpful.

Secretary SAMUELS. Yes.

[The information referred to follows:]

Between 1978 and 1994 317 FCC tax certificates were issued under the minority ownership program. Radio stations sales represented about 83.2% of the certificates issued, television stations 8.2% and cable television systems 8.6%. OTA assumed similar levels of activity would continue for purposes of preparing a revenue estimate.

The CHAIRMAN. I apologize for rapping the gavel, Senator Nickles. What we are up against is votes this afternoon, and I want to get the third panel on this morning if I can. It is my plan to run right up to close to 1:00 before we adjourn for the meetings, and the second round of questions here will have to be limited to three minutes.

Senator D'Amato? This is still the first round, however.

Senator D'AMATO. Thank you very much, Mr. Chairman.

Pursuing Senator Nickles' question as it relates to the numbers of people involved, if there are 359 transactions over that period of time, can you tell us how many of those people were involved multiple times? In other words, were some of them involved two, three, four, and five times?

Mr. KENNARD. Some, yes.

Senator D'AMATO. So it would not be 359 different individuals, it might be quite a few less.

Mr. KENNARD. No. It would definitely not be 359 individuals. How many individuals, we do not know. We could provide that information to you later. Sure.

Senator D'AMATO. Would you?

Mr. KENNARD. Sure.

Senator D'AMATO. I think that would be important.

I think it is also important to focus in on this question of tax deferral because as it relates to the Viacom situation, I have been informed that when we use the figure for loss of revenue of $400–$600 million, that kind of makes a big, sensational situation.

I have a little problem with reaching back and changing the law because we may not like an individual, or whatever. That kind of bothers me. In the 1986 tax bill—I do not mean to create a situation—I always felt that one of the horrible—well, I will now. One of the horrible situations——

The CHAIRMAN. You are out of order. [Laughter.]

Senator D'AMATO [continuing]. Was reaching back retroactively as it impacted on contracts that were in force. And if we want to take a look at the collapse of real estate markets and values, et cetera, I think a good deal of that was attributed to the ex post facto or the reaching back nature.

If you are going to say, we are going to change the law from this point forward for investors, that is fine. But to say that people who have already made contracts, invested, put money in, et cetera, relying on what the tax provisions were, that we are going to change it now and wipe out, even if they were shelters, and that is what happened.

To some extent, it seems to me, that it is easy to knock the heck out of the big guy, in this case Viacom, and Mr. Washington, who, by the way, does not have a good track record as it relates to holding these properties. That is what some of my colleagues are concerned with. You know, you flip this and there is something that flies in the face of trying to encourage minority ownership and participation in programming, et cetera.

Now, I mean, that is crazy. For you to allow or the rules to permit 1 year and you flip it, notwithstanding that the average is three and a half, or maybe five, it seems to me that should be changed. You really want minority ownership, you really want difference in programming.

If you do, then we have got to tighten up. This thing is a mess. This is an absolute mess. And it invites the kinds of things where a limited group comes in, makes a quick buck, and turns it over. So you are taking advantage of a situation that was not intended to do that, it was intended to diversify, et cetera. So, I certainly think there has to be something done.

But let me ask this question. Because there are other deferral provisions under the law, such as mergers and stock swaps, et cetera, can you really say that the Treasury Department would lose $400–$600 million? Can you really say to Viacom—I mean, are they stupid? I mean, you do not think they are going to proceed in the most disadvantageous tax way there is? I mean, do you really think so? You are the Treasury guy.

Secretary SAMUELS. Senator D'Amato, as I said earlier, we are——

Senator D'AMATO. I should not be addressing that towards you. But I am saying, realistically——

Secretary SAMUELS. Right.

Senator D'AMATO. [continuing]. Should we be able to say that we are going to lose $400–$600 million if this proceeds? Because that obviously gets the American public and people angry, and it got me

angry. I said, what the heck is going on? But is that really the case?

Secretary SAMUELS. Senator D'Amato, when we prepare our revenue estimates we take into account behavioral effects.

Senator D'AMATO. Right.

Secretary SAMUELS. So we would take into account, if you repeal 1071, that there would be behavioral effects and some people, not all, would structure their transactions in other ways to defer tax.

Senator D'AMATO. Well, what do you think Viacom would do? If we are going to talk about behavioral, do you think they would go forth with the same kind of situation or would they enter into a stock swap, for example?

Secretary SAMUELS. Senator, I do not have any way to comment on what Viacom may or may not do.

Senator D'AMATO. What would you do if you were their counsel advising them? What would any prudent counsel tell them, go ahead in a situation where you are going to pay $400-600 million, or look for an alternative? I mean, let us be reasonable now. You are an attorney, are you not?

Secretary SAMUELS. Yes. I think there——

Senator D'AMATO. What would you advise if they were your client?

Secretary SAMUELS. I would ask them whether they need the money first, and then find out whether——

Senator D'AMATO. And would you not find a way in which you could cut down on your liability, and are there not a number of alternatives that would shelter and keep them from paying that $400-600 million in taxes that they otherwise would escape by use of the certificate?

The CHAIRMAN. What they might suggest is a stock swap where you pay no tax.

Senator D'AMATO. Yes.

Secretary SAMUELS. But then you do not have the cash if you want the cash.

Senator D'AMATO. There are always trade-offs.

The CHAIRMAN. You also do not pay the $400–$600 million in taxes, in which case you do not have the cash either. [Laughter.]

Senator D'AMATO. All I am suggesting is that it is an oversimplification to say that the American taxpayer is going to lose this $400–$600 million. There is a good probability that that is not the case. That is what I am saying.

Thank you, Mr. Chairman.

Senator MOSELEY-BRAUN. Mr. Chairman?

The CHAIRMAN. Senator Pressler.

Senator MOSELEY-BRAUN. Mr. Chairman, before Senator Pressler starts, with regard to Senator D'Amato's comment—and this will come out later in the testimony, but I did not know if you would be here at that point in time—it is my understanding that Mr. Washington has never sold any of the properties that he has bought under this, and that part he will be able to testify to himself. So, he does have a good track record in terms of the holding period issue.

Senator D'AMATO. I was advised to the contrary. If I am wrong then I stand corrected.

Senator MOSELEY-BRAUN. He will testify himself, I think, to that.

Senator D'AMATO. But it seems to me, and the point was, we certainly should build into the law a reasonable holding period to accomplish the aims and goals of the program.

Senator MOSELEY-BRAUN. Right. Right. Absolutely.

The CHAIRMAN. Senator Pressler.

Senator PRESSLER. Thank you, Mr. Chairman.

I am curious about one thing. We are told that it has been scored at $1.6 billion over the next 5 years. So, if somebody wants to figure it out, how many people do you anticipate will be helped in that 5-year period?

Secretary SAMUELS. Senator Pressler, I do not have that information. When we prepare the revenue estimates our estimators look at all the available information and from that determine what they think the revenue impact from a particular proposal is.

I would say, in this particular context, we are looking at the deferral of gain, not by the purchaser, not by the person who winds up with the communication property, but with either the seller or the investor.

So these are tax benefits that are given to sellers of properties and to certain investors in the——

Senator PRESSLER. But my point is, the Administration or somebody over there has figured out that continued funding of the FCC tax certificate program has been scored at $1.6 billion over 5 years in lost revenue to the Treasury. So, somebody must have figured out how many people do they anticipate will participate. Can you get that number for us?

Secretary SAMUELS. Yes.

[See information provided previously at page 29.]

Senator PRESSLER. But I would guess it would probably be a fairly small number of people, would it not? Do we have any estimation of how many have been benefitted in the last 5 years; how many certificates have they issued?

Mr. KENNARD. Well, we know how many certificates have been issued in the last 5 years, that is 128. Now, whether that reflects certificates to 128 different people, I do not have that information now. We could get that for you.

Senator PRESSLER. Now, we are currently working on a telecommunications bill in the Commerce Committee. But, in terms of the broadcast area, they are always talking about diversity in terms of the people who work there, and so forth. Is this really part of the objective in a communications transaction?

Mr. KENNARD. Well, it certainly is, Senator. The underpinning of the policy is to promote diversity of programming.

Senator PRESSLER. Yes. But the actual number of people who are involved here is very small, is it not? We are talking about probably less than 100 people. I would guess that there are probably 100 people who will be affected by this $1.6 billion. That would be my guess, and you can contradict me if you wish.

That is a very expensive social policy, is it not? Could we not go out and provide a job at $250,000 a year and just place people in the stations, or something such that would be much cheaper, or would it not?

Mr. KENNARD. Well, I do not know if just by giving people jobs in stations you would advance the goal of the policy, which is diversity. I think it is pretty safe to say that more than 100 people would benefit from the program over the next 5 years.

Senator PRESSLER. What I am trying to get to is, it seems as though we are operating here in a very important area without a definitive study. Usually there is a professor somewhere who has done a study of who has benefitted, how many people have benefitted, have they stayed in the business, has there been turnover. And over there at the FCC you have computers; I do not know how much of this is available.

But, as a Senator, I am struggling here because I like the goals, and we all do, but I am trying to figure out, are they working, is this thing really working. I get very mushy answers, so to speak.

Mr. KENNARD. Well, I think that is a fair point, Senator. As I had testified earlier, the FCC has not been able to do a real wholesale reexamination of this policy. They tried to do it in 1986 and Congress said, no, no changes, do not reexamine the program.

I would like to address, though, the question that you raised earlier about how many people will benefit from the program. I think you have to look not only at the people who are going to be purchasing these stations, but you also have to look at the overriding principle of the policy, which is diversity of broadcasting, i.e., diversity of the listening public, their ability to receive diverse points of view.

Senator PRESSLER. Secretary Samuels, would you please address the issue of oversight responsibilities; should they be contained at the FCC, the IRS, Treasury, or some combination thereof?

Secretary SAMUELS. Senator Pressler, as I mentioned earlier, at the present time under existing Section 1071, the IRS does not at all get involved in the granting of certificates or the oversight of the FCC, we really look at the technical applications of Section 1071.

I think if changes to the law were going to be made to Section 1071 you should consider how the IRS should be better involved in the program. I think we would think that would be an appropriate consideration to take into account.

Senator PRESSLER. Well, I guess what we are dealing with here is a social policy question, in part, in the sense that, if we are going to lose $1.6 billion over five years, it would be the same as going out and spending $1.6 billion, I suppose, in achieving this diversity in programming. Are there any other ways that we can achieve the goals of broadening diversity in programming without Section 1071?

Mr. KENNARD. Senator, over the years the FCC has looked at other ways to advance minority ownership in broadcasting and Section 1071 is clearly the most successful. Other efforts that have been tried have been marginally successful, or not successful at all.

I think it is fairly widely acknowledged, both in the minority business community and also the wider broadcast community, the public interest community, that Section 1071 has been the most effective way to remedy the problem.

Senator PRESSLER. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. Mr. Chairman, recognizing the fact that Mr. Samuels is our most generalist witness, I am going to use the first part of my time to raise some questions on issues other than 1071.

First, on Section 1033, as I understand the proposal, it would provide that the replacement purchases transactions which occurred after a date in early February would no longer be eligible for the deferral of tax that are currently available to those transactions. Is that correct?

Secretary SAMUELS. Senator Graham, that is correct, and it relates to acquisitions of property from related parties.

Senator GRAHAM. The concern I have, and I recognize that there has been a policy of abusing the date of introduction of legislation into the House of Representatives as the date of applicability, is it not correct that these transactions which involve, first, an involuntary conversion, that is, where a government agency has used its eminent domain authority to acquire private property, then followed by an up to 2-year period to determine an appropriate replacement property, are transactions which, from their inception, i.e., when the government agency first indicated its interest in securing the private property until its conclusion, generally cover a significant period of time?

Secretary SAMUELS. That is correct.

Senator GRAHAM. In that context, there seems to be a degree of unfairness in the middle of the transaction. After the governmental agency has declared its intent to condemn, it has gone through the condemnation process, has involuntarily taken the property, quite rightly the private landowner had in the back of his or her mind during this process the tax advantages which would be available after the involuntary conversion if there was a subsequent replacement and may, in fact, have taken that into account in the negotiation with the public agencies as to what final terms and conditions of the involuntary conversion were agreed to. Now, after all of that has occurred, we say your expectations are not going to be realized. Do you find that to be somewhat of a troubling application?

Secretary SAMUELS. Senator Graham, I think we would certainly be willing to take a look at the effective date of this particular bill. I think, from a policy perspective, this particular section is basically saying, if you already own property you should not be able to count that as replacement property because you already own it. That is kind of the basic policy position behind this section.

But then when you get into an effective date, I can see where there could be a case where somebody might have been caught off guard. As I say, we would certainly be willing to look at the effective date to make sure that no one who had been in process was inadvertently adversely affected.

Senator GRAHAM. I wonder if you might do that and, as part of that, look at the question of whether the taxable event might be the date of the involuntary conversion rather than the date of the subsequent purchase after the involuntary conversion, including calculating what the revenue consequences of making that shift would be.

Secretary SAMUELS. Senator, we will look at that.

Senator GRAHAM. The second area in which I would like to ask questions relates to the purpose of this legislation, which is to make permanent the 25 percent deduction on self-employed health insurance. Do you have any comments, Mr. Samuels, relative to any areas of suggested reform or modification in that deduction?

Secretary SAMUELS. Senator Graham, I think our objective at the moment is to have an extension of the 25 percent deduction for self-employed. As you know, it expired last year so those taxpayers who are filing their tax returns for 1994 are faced, at this point, without being able to claim the deduction.

There are 3.2 million self-employed taxpayers that we have estimated will be adversely affected, and our principal goal is to get the extension done as quickly as possible so that they will not have a disruption in this filing season and be required to file amended returns.

Senator GRAHAM. Well, my concern is that we are going beyond what is necessary for that because we are proposing to make this a permanent extension. In the last several years extensions have been for a specific period of time and, as witnessed, that time ran out in 1994, and that is why we are considering this.

I know that there has been a precipitous drop in the number of persons covered under employed health insurance and the deductions. I think it dropped from approximately 65 to 70 percent of eligible Americans to under 60 percent. I wonder if there has been any similar decline in the use of the self-employed health insurance program and, if so, does that indicate any policy modifications that we should be considering?

Secretary SAMUELS. Senator, I am not aware today of any numbers on that. But what we are concerned about is if we do not expeditiously extend the provision, that you might see a further drop because the self-employed will not have the benefit of this deduction.

Senator GRAHAM. Just to conclude, I appreciate the sense of urgency. To me, there is some inconsistency between urgency, what we know about other areas of health insurance and some of the problems that are being encountered, and then making this a permanent extension.

Secretary SAMUELS. Right.

Senator GRAHAM. I would like to ask, Mr. Chairman, if Mr. Samuels or some other appropriate person in the Administration might suggest to the committee any areas that they consider to be appropriate on a policy basis for reform in this deduction. Thank you.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman.

I thank our panel of witnesses for their testimony. Let me start and say very clearly that I believe in the concept of diversity in society very strongly. It is something that we as Americans should support, and clearly I think we all do.

I think in the public sector it is even more important, and that is what we are talking about here, the public sector being the public airwaves, which all Americans own. Diversity voice in those airwaves, is very important.

But, Mr. Chairman and my colleagues, I think that we have been telling the FCC today that this policy is a mess. The concern I have

is that back in 1988, Congress told the FCC not to review this policy, not to make any changes in this policy, and not to undertake even a study of whether this is a good policy or not.

So, when we are looking for who to blame on this I suggest we ought to look at the Congress. It is like the old saying, we have met the enemy and it is us. We specifically told this agency not to even review Section 1071 with regard to the tax certificates for minority purchases of broadcasting equipment.

So, if we are looking for why it went wrong, we should look at Congress. When Congress said, do not even take a look at this policy, we made a pretty strong statement that we like it the way it is—do not make any changes. Not only that, we said do not even study this policy.

I have two points. Number one, is the policy working? It seems to me that somewhere in the neighborhood of about 330 or 359 certificates have been issued since 1943, back when we first started this program.

Mr. KENNARD. Not exactly, Senator. Since 1978 there have been 359 certificates that have been issued in the minority context.

Senator BREAUX. O.K. In the minority context since 1978.

Mr. KENNARD. The minority context. Yes. Yes.

Senator BREAUX. Here is my question then. The FCC's testimony says that about 2.9 percent of all broadcast licenses are in minority ownership hands, 2.9 percent of all the licenses in the United States of America. When we started the policy in 1978 it was 0.5 percent.

So the question to the FCC is, is this working as policy? Have we reached the stage of diversity in ownership that this program was put together to accomplish, with this growth from 0.5 percent to 2.9 percent? It has cost us an awful lot of money to get that 1.4 percent increase.

Senator BRADLEY. 2.4.

Senator BREAUX. 2.4. Sorry.

Mr. KENNARD. One way of looking at that question, Senator, is that does the tax certificate, in itself, work to advance minority ownership? I think the answer to that is, yes. There has been an eight-fold increase since 1978, and most of those stations that were acquired by minorities were acquired through the benefit of the tax certificate policy, and in many, many of these transactions, the tax certificate policy was a condition to the deal.

That is, but for the tax certificate, the seller would not sell to a minority. So, do we have a long ways to go to increase that 2.9 percent number? Yes. But does the FCC's tax certificate policy help to increase that number? Yes.

Senator BREAUX. Does the FCC think that there are other ways to accomplish this diversity other than through a tax certificate program?

Mr. KENNARD. We are looking at some other ways. We have some proposed rules out now that look at creating some incentives through the multiple ownership rules. We have proposed what we call an incubator program which would give established broadcasters some relief from other regulations if they undertake to help finance and train minority broadcasters. But I think that——

Senator BREAUX. It is important to note, for the purposes of the Finance Committee, that these other alternatives do not involve tax dollars.

Mr. KENNARD. That is correct. But the FCC is not proposing these other changes in lieu of the tax certificate policy, but whether to supplement it.

Senator BREAUX. I understand that. So, I guess it is an eight-fold increase, but it is only a 2.4 percent increase.

Mr. KENNARD. Correct.

Senator BREAUX. If we decide today that this policy is a bad policy—and I think Senator D'Amato was going through with this line of questioning—if we decide that this is too expensive or that it is not working, the question is, should we retroactively affect the change?

I am concerned that when a company relies on a statute of the Congress that has been on the books for a very long time, is it appropriate and proper for the Congress—Les, I guess this is more a tax question—to change the policy, not prospectively, but to change it retroactively after companies and individuals have relied on it, for good or bad? Whether it was a good law or bad law, it was the law, and it is the law. Should we change it? If we do change it, is the recommendation to change it retroactively?

Secretary SAMUELS. Senator Breaux, I think, as you know, there are a wide variety of effective dates that Congress adopts when they make tax changes and some of them are effective as of the date of a closing of a transaction. This particular transaction that you mentioned has not closed. But sometimes Congress does give, in effect, transition relief for binding contracts, then it is just a question of how you define a binding contract.

So, if you look back through the Internal Revenue Code, there has been a wide variety of approaches taken. I think you just have to look at the end of the day as to what kind of change this committee decides——

Senator BREAUX. Oh, I understand our options. But you do not have any policy recommendation from the Administration on what we should do?

Secretary SAMUELS. We oppose the complete repeal of 1071, so that is our position. I think I would say to the committee, to the extent that you are looking at not a complete repeal and looking at some kind of changes, then I would say, after you get finished with looking at those changes, then you decide how those changes ought to affect transactions that are under way.

Senator BREAUX. Thank you.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. I have no questions, Mr. Chairman.

The CHAIRMAN. Mr. Kennard, several times you have been asked questions, by Senator Bradley, by Senator Pressler, and you keep coming back to minority ownership rather than programming. We ask programming, you come back to minority ownership. Are you suggesting the policy is minority ownership rather than programming or are you pinioning the minority ownership on programming?

Mr. KENNARD. No. The policy is diversity, the policy is programming. To get there, we get there by ownership.

The CHAIRMAN. All right. In the awarding of wireless telephone licenses where there is no programming problem, how do we justify minority ownership?

Mr. KENNARD. Well, in that area—the tax certificate is used in the wireless context, in PCS—Congress specifically asked the FCC to consider using tax certificates to promote the ownership of PCS facilities by minorities, women, and small businesses.

The CHAIRMAN. That is correct. That is an appropriate answer. If we did not specifically direct it, we certainly asked you to use that. The reason I am pursuing this, is there may be a change of climate coming in this country—and you can see it in the California initiative—where there is going to be a feeling that licenses and government actions should not favor minorities where there is no evidence of discrimination.

Is there any evidence of discrimination in the awarding of wireless telephone licenses or in the sale of wireless telephone licenses, if we have even gotten to that stage yet, where one person sells them to another person?

Mr. KENNARD. Well, in the wireless area the tax certificate arose in a very different context. There, Congress was authorizing the FCC to auction off licenses for the very first time.

The CHAIRMAN. Yes, I know.

Mr. KENNARD. There was a concern that if people were asked to pay for licenses, those who had money would get all the licenses, that there would be a concentration of licenses in the hands of a few established industry giants.

So Congress, in recognition of this fact, and also in recognition of the fact that small businesses, minorities, and others have challenges in accessing capital, said that there should be some mechanisms to ensure that all those licenses did not go to the haves, but some should go to the have nots. So, this was irrespective of the diversity hook that we have in broadcasting.

The CHAIRMAN. That is correct, because you have no diversity argument on wireless telephones. I want to call Senator Bradley, he and I talk. I want to call Senator Breaux, he and I talk. There is no programming issue involved. You cannot use program diversity as an argument for wireless telephone licenses.

Mr. KENNARD. Correct.

The CHAIRMAN. All right. Now the fundamental question. Should it be the policy of government to award preferences to minority for the purpose of encouraging minority ownership where there is utterly no evidence of past discrimination?

Mr. KENNARD. As a legal matter, we do not have a compelling governmental interest in doing that. As a policy matter, I think it is appropriate for government, when licensing a scarce resource like the spectrum, to make sure that there is inclusiveness and that minorities and others who have been excluded from those licenses in the past——

The CHAIRMAN. Because they did not have access to capital.

Mr. KENNARD [continuing]. Because they did not have access to capital, have opportunities to participate.

The CHAIRMAN. And that should be remedied by the awarding of the licenses rather than trying to get at the root cause, which is the access to capital.

Mr. KENNARD. Well, what we have done in the auction context which you raise is to do it in the most minimally intrusive way. The FCC has not said that a set number of licenses have to go to any particular group.

What we have done is we have created market incentives like the tax certificate, in the auction context, it is bidding credits and installment payments, to increase the flow of capital to those groups that have had trouble getting it in the past. I think that is totally appropriate.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. I have no questions, Mr. Chairman. I think we have had our two distinguished witnesses here for more than two hours, and we have two panels yet to come.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Mr. Chairman, just for the record, and I will not take long, I would like to call to your attention and to the attention of the members of the committee, there was a CRS study by the Congressional Research Service in 1988 that found a strong correlation between minority ownership and diversity of programming.

Subsequently, I would also call to the attention of the committee that in Supreme Court cases the court has been very clear. This is from Associated Press versus United States. "Safeguarding the public's right to receive a diversity of views and information over the airways is, therefore, an integral component of the FCC's mission, serves important first amendment values, and is, at the very least, an important governmental objective that is a sufficient basis for the policies in question."

So, what we are talking about is not just minority ownership per se, but rather the interests of the larger community as well in diversity of voice, and that is the policy that is represented here.

Finally, Mr. Chairman, I would like to point out that we are dealing in a context in which a lot of the original licenses for broadcasting were basically given away by the FCC, and so here we are now, what, 60 years later, raising the bar, or discussing a raising of the bar, with regard to a scarce resource that was given away for nothing at the outset, at a time when women, certainly, and minorities, were not able to participate in the distribution of that resource.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. Mr. Chairman, I had my questions answered earlier. In deference to the number of witnesses we have, I will forego any questions.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Mr. Chairman, I would only ask the Treasury, if they could, to confirm that like kind exchanges, which are essentially non-taxable real estate transactions, the number over 5 years is $4.1 billion is correct. That is the number I have. If not, could you check that?

Secretary SAMUELS. I will check that, Senator.

[The following information was subsequently submitted:]

In its November 1994 report on tax expenditures, the Joint Committee on Taxation (JCT) included a FY 1995–FY 1999 tax expenditure estimate for this item of $4.1 billion. OTA does not include this item in its tax expenditure budget.

Senator BRADLEY. And also, non-taxable stock exchanges, Sections 351, 354, and 368 of the Code. I am told there is no way to estimate the revenue effect of those exchanges because they are never reported. So, if that is wrong, I would like to have the number for Sections 351, 354, and 368, in addition.

Secretary SAMUELS. Yes.

[The following information was subsequently submitted:]

Neither OTA nor JCT include these items as tax expenditures. Senator Bradley is correct that these exchanges are not reported on tax returns.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

A factual question. Do you have a breakdown of the certificates that have been issued for television, radio, and cable TV?

Mr. KENNARD. Yes, I do, Senator. There have been 285 tax certificate in the radio area, 43 in television, and 31 in cable TV.

Senator GRAHAM. How many in cable TV?

Mr. KENNARD. 31, sir.

Senator GRAHAM. Is the issue of diversity of broadcasting as compelling with cable TV as it might be with television and radio?

Mr. KENNARD. I think it is. The owner of a cable television system, as you know, has to program many channels and has control over what programming goes out over those channels. So, to the extent that there is editorial control, and there certainly is, minority ownership does advance that in cable as well.

Senator GRAHAM. Has the FCC done an evaluation of the programming that the cable system was distributing prior to the change in ownership, and then the consequence of that change of ownership on programming?

Mr. KENNARD. No.

Senator GRAHAM. Well, how do you know that the change in ownership in a cable situation resulted in a difference in the information and programming which the audience received?

Mr. KENNARD. I think it has been inferred from the broadcast context, but a study in cable has not been performed, no.

Senator GRAHAM. It seems to me that cable, which essentially is a distribution system as opposed to an origination system, raises different policy questions.

Mr. KENNARD. I think it does. I think it is a fair ground for inquiry.

Senator GRAHAM. Thank you.

The CHAIRMAN. Senator Breaux.

Senator BREAUX. No questions, Mr. Chairman.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. No questions, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you very, very much. We appreciate it.

Now, if we can move to our second panel. Mr. Raul Alarcon, Mr. Tyrone Brown, Mr. W. Don Cornwell, Bruce Fein, Michael Horowitz, Robert Johnson.

[Pause]

The CHAIRMAN. Gentlemen, welcome. As I indicated earlier, if you would be so good as to hold your opening statements to 5 minutes, we will have ample questions to ask you. We will start with

Mr. Raul Alarcon, who is the president and owner of the Spanish Broadcasting System, from New York.

STATEMENT OF RAUL ALARCON, JR., PRESIDENT AND OWNER, SPANISH BROADCASTING SYSTEM, NEW YORK, NY

Mr. ALARCON. Good morning, Mr. Chairman.

The CHAIRMAN. Welcome.

Mr. ALARCON. Good morning. Thank you. Thank you, and members of the committee.

My name is Raul Alarcon. I am the president and chief executive officer of Spanish Broadcasting System. I greatly appreciate your offer to testify today concerning the proposed repeal of Section 1071 of the Internal Revenue Code and the impact of this action on the Hispanic community.

Spanish Broadcasting System is a family-owned and operated company founded in 1983. At the time of the Cuban Revolution my father owned a chain of radio stations that were seized by the Castro Government. We came to this country as refugees, with very few possessions. We became U.S. citizens and my father worked his way up in Spanish-language radio, working jobs in programming, sales, and advertising.

Finally, more than 20 years after we left Cuba, my father and his Hispanic partners mortgaged everything they had to buy a small AM radio station licensed to Newark, New Jersey. That was 1983. Today we are the largest Hispanic-owned media company in the U.S. SBS owns and operates seven radio stations in major markets: WSKQ AM and FM, serving northern New Jersey and New York City; KXED AM and KLAX FM in Los Angeles; WCMQ AM and FM serving Miami; and WZMQ FM in Key Largo.

Every one of these stations provides Spanish-language programming 24 hours a day, 7 days a week, 365 days a year, and every one of them was purchased with a tax certificate.

Two weeks ago the House of Representatives voted to repeal Section 1071 outright. Not to amend it, nor to reform it, but to repeal it. I believe that was a mistake, Senators, and I would like to explain why. In my view, the vote in the House of Representatives reflects a deep misunderstanding of the tax certificate program and of the radio broadcast industry.

In my view, far too much attention has been given to the impact of the tax certificate program on the sellers and buyers of radio stations and far too little attention has been given to the impact of this program on the minority community.

The tax certificate program has its roots in the unique character of the broadcast industry. Because the radio spectrum is limited, there are a finite number of radio licenses, only a fraction of which are available to buyers in any given year.

Unlike virtually any other business in this country, you cannot get into the radio broadcast industry at will. If you can raise the capital to open a restaurant, for example, you can go into business right away.

But, if you want to own and operate a radio station you need to raise the capital, then you must find someone who is willing to sell you their station. For minority buyers, such opportunities are few

and far between. Radio stations in major markets range in price from $40–$150 million.

The FCC's decision in 1992 to relax its ownership restrictions has made it possible for some broadcasters to buy second, third, and fourth stations in markets previously closed to them. This change in the rules has created a new group of large, well-financed bidders for available licenses and has foreclosed many opportunities for minorities.

Even if a minority buyer can raise the money to buy a station, he or she must then compete with established companies, some of them media giants, that can offer sellers tax-advantaged deals, such as tax-free asset-for-asset swaps, or stock-for-stock swaps, that enable the seller to defer tax on the transaction from the sale.

The tax certificate gets the minority buyer to the bargaining table by enabling him or her to offer similar tax advantages to a seller. Our company, SBS, has paid market price for every station that we purchased, but, for the reasons I stated before, we could not have purchased any of these stations without a tax certificate.

The tax certificate levels the playing field in the lopsided, high-stakes broadcast business. We know, therefore, on the basis of our experience, that the tax certificate program works. It is a voluntary program. It works without mandates, without set-asides, and without quotas. It does nothing more than encourage sellers to sell to minority buyers and it lets the marketplace do the rest. Believe me, Senators, the marketplace is very tough.

In 16 years there have been only a little over 300 properties bought and sold with tax certificates. Some say this is evidence that the program is of little value. I say this is evidence of how tough the marketplace is for minority buyers, even with the tax certificate. Take the tax certificate away and the number of purchases by minority buyers will all but disappear.

In your invitation to testify you asked about possible alternatives to make capital available to minorities who wish to acquire media properties. I would welcome such programs and I invite Congress to consider the merits of programs that would provide low-cost financing to minority buyers because, as we have heard today, access to capital continues to be the largest stumbling block and the largest obstacle to minority ownership in the media. These possible initiatives alone, however, in my opinion, could not be an adequate substitute for the tax certificate.

Now, you may ask yourselves, is the tax certificate program worth saving? It is worth saving because minority owners offer the single best hope and opportunity for bringing new voices and new viewpoints to the broadcast industry, and new entrepreneurs into the mainstream of the country's economy.

Our New York area stations were English-language stations before we bought them, and we were the first, and are still, the only Spanish-language FM station in New York City.

Mr. Chairman, I have some more comments. Is my time up?

The CHAIRMAN. I am afraid I am going to have to ask you to put the rest of your statement in the record because I want to try to get done with this panel and the next one if we can. We will have questions to ask.

Mr. ALARCON. Certainly.

The CHAIRMAN. Thank you very much.

[The prepared statement of Mr. Alarcon appears in the appendix.]

The CHAIRMAN. Next, we will go to Tyrone Brown.

STATEMENT OF TYRONE BROWN, OF COUNSEL, WILEY, REIN AND FIELDING, WASHINGTON, DC

Mr. BROWN. Mr. Chairman, my name is Tyrone Brown. I have practiced telecommunications law in the Washington area for the past 25 years.

First, I testify this morning as a person who served at the Federal Communications Commission. I was there in 1978 when the Commission adopted this program. I supported it, I lobbied my fellow Commissioners for it, I voted for it, I prayed for it, and I continue to support it today.

I am here also today for a second reason, and that is, in my law practice I am involved in the representation of a number of parties who are very interested in the ongoing auctions in the Personal Communication Service.

These parties are concerned that actions that the Congress is involved in right now could have a detrimental impact on what is happening in the marketplace in the Personal Communication Service, and I would like to spend most of my time talking about that because I do not think it has gotten enough attention.

About the minority ownership tax certificate program, I would like, very quickly, to try to explain what it is that we were talking about when we were talking about diversity and what concerned us back in 1978.

Back then, to convey to one of my fellow Commissioners what this fact of the state of ownership of broadcasting back then meant to us, I first expressed my conviction that television, cable, and radio are the most insistently intrusive, the most intrusively insistent, the more entertaining, information-laden, ubiquitous mass communications vehicles yet conceived by humankind. As a Nation for better or worse, we literally commune over radio and television.

And back in 1978 I tried to explain to one of my fellow Commissioners what it means to minority Americans. I asked him to imagine, if he could, a national radio/television environment in which 95 percent of the ownership of the powerful and persuasive medium, 95 percent of the control over ultimate decision making, 95 percent of the ultimate control over creative expression, 95 percent of the ultimate control over news and information content, 95 percent of the ultimate control over exploitation of the medium for profit, how he would feel if 95 percent of that rested securely in the hands of people who looked like me.

This, of course, is the reverse image of the situation that did exist in 1978. While minority Americans then represented approximately 20 percent of our populations, minorities own not much more than one-half of 1 percent of all broadcast properties.

Now, the program that we thought we were establishing was a modest program. We believed that the tax certificate policy would have a modest impact on ownership patterns. The record demonstrates that it has. There have been 16,000 sales of television and radio stations since 1978. We have heard this morning that ap-

proximately 350 of those have been to minorities under the tax certificate program. That represents less than 2 percent of the total sales.

That fact impresses on me that without this program what we will see, certainly, is a diminishment in minority ownership. We believe that there was nothing extraordinary about the fact that issuance of tax certificate would permit the seller to defer payment of taxes. We have heard a lot about that.

I have attached in my statement which I am submitting for the record a list of five of the largest cable transactions that have taken place in the past year, either announced or completed. They range in size from $1.6 billion to $2.6 billion; all of those transactions are being done as tax-deferred transactions. Most very large transactions in this country are done as tax-deferred transactions, as reorganizations, or consolidation, or mergers, or what have you.

Now, as I indicated, Mr. Chairman, I would like to turn to the Personal Communication Service issue. The FCC has announced its intention to employ tax certificate to get the new Personal Communication Service off the ground. That is the very reason why Congress should not repeal Section 1071.

The agency plans to use the tax certificate to spur innovation, competition, as well as diversity in ownership. In the case of the Personal Communication Service, Congress itself unmistakably mandated both rapid deployment of the new technology and diversity in ownership and participation.

This new service, Mr. Chairman, is the next generation of enhanced cellular cordless, wireless communications devices. Today, as we sit here, the FCC is in the midst of conducting the auction for this particular service. Potential providers of this service have committed at this stage to pay $6 billion into the United States Treasury this year.

It is expected that this service is going to generate $50 billion in new revenues in the next 10 years, and that it will serve 30 million people. If the Congress decides to repeal Section 1071 and the tax certificate authority is not available to the FCC to get current users of the allocated channels to move to other channels, then service will not go forward.

The CHAIRMAN. I have to ask you, Mr. Brown, to wind down.

Fellows, let me say something to you. I know it is difficult to talk in 5 minutes, although George Abbott, the great theatrical producer, once said, if you cannot write your idea for a play on the back of my business card you do not have an idea for a play.

There is a way to do this in a short period of time. The greatest witnesses we have ever had, we then asked questions for an hour and they get ample time. So, think to yourself, what is the main point I want to get across in 5 minutes.

Mr. Cornwell?

STATEMENT OF W. DON CORNWELL, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, GRANITE BROADCASTING CORPORATION, NEW YORK, NY

Mr. CORNWELL. Thank you, Chairman Packwood, Senator Moynihan, members of the Finance Committee. I am Don Cornwell,

chairman of the board of directors and chief executive officer of Granite Broadcasting Corporation. I appreciate the opportunity to appear before you today in support of Section 1071 of the Tax Code.

Granite owns and operates seven network-affiliated television stations across the country in California, Illinois, Minnesota, Wisconsin, Indiana, New York, and Texas. We are in the process of acquiring an eighth station in Michigan. We currently have approximately 750 employees and about 200 shareholders, as we are a publicly-owned company at this point.

The tax certificate program has been instrumental in our growth from the start. In 1988, clearly benefitting from the availability of a tax certificate, Granite bought its first and smallest stations in Duluth and Peoria.

My investment, which represented then and today virtually all of my family's net worth, bought the majority of the voting stock in Granite. No one has the right, I might add, to buy my equity position or to exercise any of my rights as the controlling shareholder.

I want to emphasize that my objective since 1988 has been to build a strong company, a company which can compete in the 21st century. Thus, we continue to own each station we have acquired to date, despite receiving attractive offers to sell.

Mr. Chairman, much of recent press discussion has been about the Federal Government's role in encouraging minority ownership of media properties through affirmative action programs. I was glad to hear your historical perspective at the outset of this hearing. Frankly, I do not view the minority tax certificate program as an affirmative action program.

This program emanates from Congressional, regulatory and judicial directives based on the First Amendment to promote diversity of views in the public airways. Thus, encouraging minority ownership of media properties is a means to an end, not an end in and of itself.

My own experience tells me that editorial policy does follow ownership. Each community served by our stations, we believe, has benefitted from the diversity of viewpoint that we have brought to that community.

For example, after Granite acquired a west coast television station in 1993, our new general manager appointed by us immediately formed an Hispanic advisory council and a community advisory council, both of which meet quarterly with station management.

As a result of these meetings, the station honored five Hispanic community leaders in its newscasts and with on-air vignettes throughout last September's celebration of Hispanic Heritage Month. In February, that same station honored five African American community leaders in celebration of African American History Month.

We believe that our station is by far the most aggressive in that particular market in reaching out to the minority community.

The tax certificate program has been extremely important in the development and growth of our enterprise. We have used the tax certificate to persuade owners to focus on our proposals. For example, we were able to persuade companies such as Pulitzer, Land-

mark Communications, and Meredith, to sell us television stations which they had not intended to sell.

I can assure you that in five of our eight acquisitions to date, including the current acquisition of a Michigan station, there would be no deal without the certificate, thus, Granite would not exist as a viable local broadcaster. Yet, we believe the Treasury would not receive revenue since these stations would not have been sold.

The minority tax certificate program efficiently promotes program diversity. Market-based economic incentives, in our opinion, are the best way to encourage both station owners to sell to minority purchasers and investors to provide start-up capital to minority broadcast companies.

Other alternatives, in our opinion, are less desirable: direct grant programs or mandating programming by the licensee which requires the Federal Government to decide how best to allocate resources or to determine program content; and public access requirements, I think we all know, unfairly restrict an owner's ability to exercise editorial discretion in the operation of a station.

Much of the debate in the House of Representatives questioned why the tax benefit under the minority tax certificate program should go to the seller of the property, who is often a non-minority owner and not to the minority purchaser.

I am proud to say, first of all, that Granite has always negotiated a lower price or better terms because of the tax certificate. This has been immensely helpful in our raising of capital.

Second, I frankly do not see the difference between the minority tax certificate policy and many other incentive-based provisions of the Tax Code. For instance, I am sure that tax incentives offered to entrepreneurs who invest in enterprise zone businesses often inure to those who are not economically disadvantaged. In both cases, the economic result is appropriate because the ultimate goal of the program is advanced.

We share your concerns about potential abuses of this program. We want to work with you to develop ways to ensure that the spirit of the program is satisfied. We believe that satisfaction of that spirit requires at least three standards: one, a significant at-risk investment by minority investors at the inception of the enterprise; two, executive management control; and three, the absence of mandatory rights by non-minority investors to buy out the controlling minority entrepreneur.

Further, we believe the Congress and the FCC should require a written representation and warranty from the recipient of the tax certificate that these or other appropriate standards have been met to the best of their knowledge.

I will conclude and put the final paragraph into the record. Thank you.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Cornwell appears in the appendix.]

The CHAIRMAN. I might say to the audience and to the members of the committee, two of the panelists have referred to First Amendment rights. I think you are probably referring to the Red Lion Broadcasting Company's unusual decision, I thought, in 1969, where part of its pinioning of the right of the FCC to allocate fre-

quency, apart from scarcity, was the First Amendment rights of the listener, which is something I am not sure our founders ever would have conceived of when they talked about the First Amendment right of speech.

But they extended it—I think it is a questionable decision—to the listener and the First Amendment rights of the listener to receive information, which is an unusual interpretation of the First Amendment.

Mr. Fein?

STATEMENT OF BRUCE E. FEIN, EXECUTIVE EDITOR, WORLD INTELLIGENCE REVIEW, AND ATTORNEY, GREAT FALLS, VA

Mr. FEIN. Thank you, Mr. Chairman, and members of the committee. I will focus my remarks exclusively on what I consider to be the theory of diversity behind this particular program. I think the justifications are no more than nonsense on stilts.

There is behind the idea that minority ownership will bring necessarily a distinctive kind of programming that could not be achieved by anybody with a different skin color, a racist thinking, something that Justice Clarence Thomas has said amounts to thinking that all blacks are the same, which we know, of course, is not true. There is every bit as much diversity in the black community as the white community, and it extends back to the time of disputes between Booker T. Washington and W.B. Debois. Gary Franks, a black member in the House of Representatives, certainly is not likely to echo views of, perhaps, Senator Moseley-Braun.

And if there were an ability to identify a distinctive kind of programming that was done because of the skin color of the owner you would think that the FCC, the GAO, or someone would monitor, they would be able to identify and determine that diversity is achieved, because this kind of particular program on South Africa would have been portrayed in a different way if the owner of that station was a different skin color.

There has been an acceptance here that in the free marketplace, dealing with regulations, those who own, those who are in business, seek to make profits, they seek to avoid taxes. Everyone recognizes that what drives these transactions under 1071 is an economic motive, naturally.

The same is true with ownership. A broadcast station. What drives the programming is making profits, appealing to the audience. When Hallmark Cards bought many stations that previously were owned by Hispanics and were catering to a Spanish audience, they kept the programming. It brought in money.

Avarice is colorblind; it works everywhere. The idea that simply by diversifying the skin color or ethnicity of the owners of the station you thereby diversify programming, as I say, is nonsense on stilts, and then has been no showing that there is such a correlation. It is contrary to what our own experience would teach.

The Supreme Court in the Metro Broadcasting case in 1990, a 5-4 decision. Four of those five in the majority are now gone from the bench and I do not think it would be sustained if it is reviewed again. They referred to some generalized studies that sought to identify some kind of programming diversity, but those studies, again, are equally amorphous. I would ask——

The CHAIRMAN. Those studies are what?

Mr. FEIN. Are amorphous in their attempt to actually pin down what kind of programming satisfied "a diversity theory." As Senator Moynihan has pointed out, how do you identify a program that is catering to an Irish audience, a Polish audience, an Italian audience, on the basis of what the ethnicity of the owner is?

If you have got the audience that wants to listen and you make money, sure you tailor your programming that particular way. Indeed, the programming can respond to the audience, and will, irrespective of the skin color.

If the FCC is using this preference program for diversity purposes, why is it extending them to Personal Communications Service licenses? That has nothing to do with the audience, what you call the right of the listener to have some diversity. There is no programming in Personal Communication Service licenses. If it is diversity based upon numerical diversity that is the goal, why are persons permitted to take advantage of the program one, two, three, four times?

It certainly seems odd that, as the FCC is lifting the multiple ownership requirements so that a single individual can own many, many television and cable stations, if they are so concerned with diversity based upon pure numbers and different voices, that is totally inconsistent with that idea because if you think that you are getting diversity just by having different numbers of owners you would think that the multiple ownership requirements would be reduced.

I think that we have grown up for many, many years prior to recent times automatically assuming that anything in any way that would promote a certain kind of representation across the board of all racial, ethnic, or other groups, was necessarily good; whether we called it quotas or otherwise, that is basically what it was.

I think this diversity theory is just a contrived effort to mask an effort to simply promote particular races and ethnic groups because it is politically attractive and it is politically correct for that time and place. I thoroughly oppose the provisions in 1071 that are race and ethnic based.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Fein appears in the appendix.]

The CHAIRMAN. Mr. Horowitz.

STATEMENT OF MICHAEL J. HOROWITZ, SENIOR FELLOW, HUDSON INSTITUTE, WASHINGTON, DC

Mr. HOROWITZ. Mr. Chairman, it is in some measure for me ironic that we are in a hearing room named after Everett Dirksen. I remember those days when he was here fighting to make the civil rights struggle a moral struggle.

I lived in Mississippi in the late 1960's teaching the first integrated classes at the University of Mississippi Law School, and I saw the morality that was inherent in the civil rights movement that really made us, as Lincoln said, we were, the last best hope of mankind.

Here we are this morning defending a program which will give specialized tax breaks, as Dick Zimmer said on the House floor, to two rich white guys, and the means by which it is done legally—

this proves Mike Kinsley's point, that what is troublesome in Washington is not what is illegal, but what is legal—is to give a reported $5 million profit to a man who will hold it for a 3-year cup of coffee and then cash out his status. He is the conduit in between here.

What makes it even more appalling is that this man who will be getting this was the man who helped shape the program when he was at the FCC. He is a millionaire already from four dips at this program, this is his fifth. And have we come to this in the name of civil rights? I read your book, Senator Moynihan, and I do not think we have.

As a conservative, I feel particularly troubled by this because, when I was the General Counsel at OMB I used to see conservatives, rightly in my judgment, talk about the evils of welfare, the need for people to earn, the need for people not to get their money through the public fisc, through politics and dependencies. But we conservatives always talked that way when we were talking about welfare for poor people.

It always struck me as appalling that when a man in a three-piece suit went on the same kind of welfare as a poor person seeking welfare, that sometimes the milk of human kindness would overflow on the conservative side. I think that has got it exactly backwards, and I think that is what the last election was about.

Now, there are a number of things which are appalling as well about this program. Senator Bradley, I remember your fight to end complexity in the Tax Code. Here is a program that adds enormous complexity in the Tax Code. It is a paradigm of what you sought to end, Senator Bradley, and I think it ought to be ended.

These are public dollars that we are expending here in a time of fiscal stringency. Next, these kinds of programs, tragically, have provided a safe harbor for conservative politicians on issues of race and the tough issues of welfare that the country ought to be debating. Finally, the program does not work.

Nancy Johnson pointed out on the House floor that the increment in ownership is "far more rationally attributable to the growth of wealth in the minority community since the inception of the program." We are not talking about any substantial increments here. Why, the number of minority millionaires has probably increased during the period of this program at a much faster rate than the number of owners under this 1071 program.

We run into the consistent post-hoc fallacy in defending this program: because 300 sales have been made to maybe 150 people, why, they would not have happened without this program. I ask, where is the proof, and I say, as Nancy Johnson did, bunk.

Let me also say, Senator Conrad, I heard you ask the question about whether only 30 percent still hold licenses from the original sellers. It is actually worse than that. The snapshot that is taken in 1992 of the people who got the tax certificate only shows that there are 30 percent of the original minority "owners" who still own the program, but the fact is that that snapshot is taken from the inception of the program up to 1992. So, you have got an awful lot of people who have not yet held it for a year or for 2 years.

So, even that percentage overstates, and that assumes that there is an accurate calculation of who is a minority, and I am not sure

about that. We have had Jack Kent Cooke dip at the well four times. We have had enormous kinds of benefits.

Let me say also that this program is unconstitutional by the reasoning of the Supreme Court. Senator Packwood, your colloquy with the General Counsel of the FCC was extraordinary. You kept on pressing him to justify the program in terms of the sole basis on which the Supreme Court said it was constitutional; he did not.

I commend to everybody Jonathan Rauch's extraordinary article in the New Republic where he talked about "diversity-mongering at the FCC" and he says, "Nobody talks about this program anymore in terms of diversity. Without any fanfare, it is justified on the basis of minority ownership as an end in itself."

Finally, my time is short, and I hope we get into the retroactivity issue for the companies involved in this transaction. I find John Malone an enormously admirable person, from all I know of him. The cable industry created itself with private money because of its upset at the government dependency of broadcasters, but the notion of retroactivity here is pure bogus. The opera was not over, the fat lady did not sing, it is an executory transaction, and there is no argument whatsoever for retroactivity here. Thank you very much.

[The prepared statement of Mr. Horowitz appears in the appendix.]

The CHAIRMAN. Mr. Johnson.

STATEMENT OF ROBERT L. JOHNSON, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, BLACK ENTERTAINMENT TELEVISION (BET) HOLDINGS, INC., WASHINGTON, DC

Mr. JOHNSON. Mr. Chairman, members of the Senate Finance Committee, my name is Bob Johnson. I am the founder and chief executive officer of Black Entertainment Television, which is a multimedia company whose principal business is the operations of the BET cable network, basic cable programming services that reaches 40 million cable households.

In 1991, BET holdings became the first black-owned company to be publicly traded on the New York Stock Exchange. From an initial investment of a half a million dollars by TCI in the person of John Malone, BET holdings celebrates its 15th anniversary with the market cap of approximately $350 million, and annual revenues in excess of $100 million.

I believe I am qualified, through my experience as an entrepreneur, to share my views on the question, should there be a minority tax certificate program to encourage minority ownership of media properties. My answer is, yes.

Section 1071 of the IRS Code should remain in effect until we as a Nation have addressed this fundamental question: why do we, in the most capitalistic economy on the globe, have to pass laws, propose regulations, or provide incentives to encourage white businessmen to join in enterprises with black-owned businesses? The answer is as simple as it is tragic.

I believe that most whites of goodwill will engage in business with anybody who has the required money. The reason they seldom invest in businesses with blacks is the simple fact that we do not

have access to the capital markets to be an equal player in the free enterprise marketplace of this economy.

How the Congress and the Administration working together can solve this problem of capital haves and have nots should be, I think, the real subject of this hearing. The tax certificate program is nothing more than the use of tax policy to achieve a desired social end: minority ownership and diversity of ideas.

It is the same principal as the tax deduction for home mortgages, a way of encouraging home ownership and asset accumulation. Both of these are laudable goals. We argue that the home ownership deduction is race neutral. It takes race not into account in terms of the mortgage deduction.

Well, perhaps it does and perhaps it does not, if you look at the fact that in many cases minorities are denied access to home mortgage loans when they present the same economic profile as whites.

The fact of the matter is, and with all respect to Bruce and some of the other commentators here who take the opposite point of view, what is not level and what has never been level in the over 200 years of this Nation's history, is access to capital and capital accumulation by black Americans because of institutionalized racial and economic discrimination.

So, I propose that this committee focus on changing that glaring inequity rather than getting bogged down into a political fight over affirmative action programs of which the tax certificate is really seen in its worst light, is simply a bribe to white capitalists to do business with blacks and, in my opinion, an insult to black entrepreneurs for not having access to capital to create a deal on an equal playing field.

Now, my proposal for solving this problem is to do this: reduce the capital gains tax. Elimination of the capital gains tax would pump billions of dollars of pent up capital into the economy which would benefit all Americans, and I am convinced that some of that capital would flow in the hands of minority entrepreneurs, just as some of that capital flowed in Black Entertainment Television in 1980.

Another thing I suggest: eliminate the capital gains tax entirely on investments, either stock or debt investments, in small businesses that are located in economically depressed areas or designated enterprise zones. If the risk is great in these areas, increase the reward by eliminating the capital gains tax.

A second idea: reduce the 50 percent reduction in the estate tax of all those individuals who invest 50 percent of their estate value in businesses that are headquartered in or have 50 percent of their employees in economically depressed areas.

Take some of that capital that is being held by very wealthy individuals and allow it to flow into economically depressed areas in communities, creating a net inflow of capital rather than a net outflow of capital.

Another idea: eliminate the Small Business Administration. Take that $750 million and create an Urban Enterprise Development Bank similar to Fannie Mae and use that agency to underpin and undergird bank lending into inner city areas, encouraging banks to put more money into the inner city community.

You will note that none of these proposals I recommend is tied to race or is race-specific. But let us not forget that a change in racial attitudes is critical to solving the problem of capital formation in the black community.Fundamentally, all Americans must understand the interdependency between black economic empowerment and the quality of the standard of living of this Nation; we cannot have one without the other. Thank you.

[The prepared statement of Mr. Johnson appears in the appendix.]

The CHAIRMAN. Thank you. I ought to tell what I thought was a cute story about you, Mr. Johnson, when you and I met. He told me about his problem in getting capital, and I think this is absolutely true, that minorities are discriminated against in getting capital in this country. I do not know what I would do if I was a banker and you would come to me and say, I have got this idea for a black network, whether or not a banker would have loaned you money or not, on the merits or not on the merits, you did not get it. Then you went to John Malone, whom you mentioned, Mr. Horowitz. Mr. Malone is one of the great entrepreneurs of this country.

Mr. Johnson said, I need $500,000. And Malone said, all right, I will give you $125,000 for 20 percent of your stock, and I will loan you $375,000. Mr. Johnson said, what Mr. Malone did not know, that for $125,000 he would have given him 80 percent of the stock. [Laughter.]

The CHAIRMAN. Mr. Fein, I have not only read the Supreme Court Metro case, but I went back and I looked at the record. Do you discount all of those studies that were presented as amorphous, irrelevant?

Mr. FEIN. Yes, because they do not have any criteria for identifying whether or not the portrayal of particular kinds of individuals or stories can be identified with a particular race, and that is the whole underpinning of this particular idea of you necessarily getting diversity in programming depending upon the skin color of the owner.

The CHAIRMAN. All right. I hear what you are saying. I do not agree with you. I did not read the studies. I went back and I read the evidence that was presented. I did not go through every study. But I thought the evidence was pretty persuasive and identifiable that minority-owned stations do program differently than white-owned stations. But I will not get into an argument with you on that.

Mr. Horowitz?

Mr. HOROWITZ. Yes. Mr. Chairman, Peter Pitch, who was a senior official at the FCC, whom you may know, has said that the three affirmative studies cited in the Brenan opinion in a footnote, are clearly ambiguous. He has gone to the studies themselves.

What we know from the two studies that are on the table now that were referred to in the Rauch piece in the New Republic—and they are the Shemet studies and the Sterling studies—content analyses done over the last 15 years shows very small differences. Says Jorge Shemet, a communications professor at Rutgers, minority-owned stations need to make money, maximize ratings, and "they operate in the same marketplace everyone else does."

Another expert, George Washington University's Christopher Sterling agrees, "What research has done so far comes up showing no significant difference."

The CHAIRMAN. That is interesting.

Mr. FEIN. There is also an inconsistency, Senator, between the recognition that when you are dealing in the marketplace, capital markets or otherwise, the name of the game in the business is to make money. That is why they are in here. Suddenly, however, that idea is abandoned when it comes to programming. People are in there, they own commercial stations, and they are going to tailor their programming to the audience.

Mr. JOHNSON. Mr. Chairman, may I make a comment on that?

The CHAIRMAN. Yes.

Mr. JOHNSON. I am the only individual that is actually engaged in 24 hours of programming targeted to black Americans, and I can assure my colleagues at the table that we program totally differently than other cable programming services that do not target our marketplace.

It is a fact of the ownership being in the hands of black Americans that determine the editorial content of the programming, from our news, to our music, to our sports, to our talent, to the entire subject matter. So, I do not know what statistics they are citing, but the fact of the matter is, editorial content does flow from your particular ownership attitude.

Mr. ALARCON. Mr. Chairman, I would like to reflect on that also. If we could just forget about the studies for a moment and take a look at Spanish Broadcasting System, Spanish Broadcasting System was created thanks to the tax certificate program.

And in most of the cases of the radio stations that we own there did not exist that programming prior to our having purchased the station. We purchased the station with the tax certificate, as Hispanics we own the station and we program them to an Hispanic audience.

By the way, some of the people here should know, in the case of the Spanish Broadcasting System our New York FM station is one of the top-rated stations in New York City, rated #5 right now, and our Los Angeles FM station is #1 in southern California. So, there is a direct, direct attributable result.

The CHAIRMAN. Do all of your stations program in Spanish?

Mr. ALARCON. All of them, 24 hours a day, Senator.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. I find this fascinating, Mr. Chairman. Not entirely clarifying.

Let me ask Mr. Cornwell, whose testimony was so helpful. I see that you own a station in Syracuse and in Buffalo.

Mr. CORNWELL. Yes.

Senator MOYNIHAN. And these are network affiliated.

Mr. CORNWELL. That is correct.

Senator MOYNIHAN. Does that give you much opportunity to do something on your own, as it were, that is particular to Syracuse, or Buffalo, or just to your own editorial judgments?

Mr. CORNWELL. I should correct for the record, Senator, that we have a major investment in Buffalo. We do not control or operate

the Buffalo station at this point, so we do not have any involvement there.

I would make the same comment with regard to Syracuse, since we took over in 1993, as I gave in the example about our California station. We have had many of the same experiences in adding new programming to that station, I should say, as a network affiliate with 50 percent of our air time being supplied to us by ABC, NBC, and CBS.

Senator MOYNIHAN. 50 percent.

Mr. CORNWELL. About 50 percent. Yes. That obviously puts us in a different position than Bob Johnson, who is programming on a 24-hour basis. But I would just say, in response to Mr. Fein's comments—and I hope it is responsive, Senator Moynihan, to your question—that I think beauty and profit is in the eye of the beholder. Lots of people would not bank Bob Johnson, and it sounds to me as if Mr. Fein would not have, because he does not perceive this type of programming as potentially profitable.

Bob had enough faith in himself and was able to find Mr. Malone to bank him and, as a result, he has produced a very successful company. So, I do not think we should assume that diversity in programming is not a profitable idea. In fact, our company would say that it is a very profitable idea.

Senator MOYNIHAN. And I think I see Mr. Horowitz about to say that if it is profitable——

Mr. HOROWITZ. I say that is precisely the point.

Senator MOYNIHAN. [continuing]. Somebody is going to do it.

Mr. HOROWITZ. It is wonderfully profitable. It ought to be profitable. We ought to have diversity, Senator. The issue is——

Senator MOYNIHAN. Well, we do have diversity.

Mr. HOROWITZ. [continuing]. Whether we have proven the nexus between who the owner is and what the diversity may be. That is the issue on the table, and there is not only no real proof of that, studies and anecdotes aside or to the contrary, and to the extent the FCC tried to study that very question which is the lynch pin of constitutionality, it was barred from doing so by the United States Congress.

If he has got a profitable station, Mr. Alarcon, anybody who buys it from him and turns it into a country music station has got to have his head examined. It is not going to happen. Hallmark just bought a bunch of Hispanic stations. They are not going to turn it into Portuguese stations or news stations. If they are profitable, they will continue them as Hispanic stations.

Mr. ALARCON. If I may answer that, Senator, for a moment. It is true that anybody who buys my radio station from me today will probably continue in Spanish; that is not the point. The point is, if Mr. Horowitz had bought the station then I do not think it would be in Spanish today. That is the point. [Laughter.]

Mr. ALARCON. That is the point that I am trying to make. I think that is what is at the crux of what we are talking about here.

Senator MOYNIHAN. Well, wait awhile. I thought Mr. Horowitz said precisely he would keep it in Spanish.

Mr. ALARCON. I doubt it. Keep it Spanish after me, I am not saying that. I am saying actually buying a station and converting it to Spanish.

Senator MOYNIHAN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much. In regards to this debate, I was reminded of the fact that Don Cornwell owns a station in Peoria, Illinois. In fact, that is how I first came to know him, or know about him. When I was running for office, all the poll numbers were coming in and they all said the same things in terms of the numbers. It was only his station that predicted that I was going to win the election. [Laughter.]

Senator MOSELEY-BRAUN. Now, somehow or another they could see something else in those same set of numbers.

But I was really interested, and I would appreciate, Mr. Cornwell, to communicate to the panel here and the listeners, you mentioned in the previous conversation activity down in Georgia with the Japanese community there. Was that your station you were telling the story about?

Mr. CORNWELL. No, I think that is another.

Senator MOSELEY-BRAUN. All right. But I guess the point needs to be made that, both in terms of the dynamics of obtaining financing, the dynamics of getting the information, which was another point that you raised with me about the industry, as well as decisions about the programming, diversity does make a difference in a positive and constructive way as opposed to taking something away from somebody. It really allows for everybody to give and for all of us to have a chance to contribute and to be heard.

If you would, for a moment, talk about the dynamics of the industry in terms of obtaining information and obtaining financing that this Section 1071 has helped with regard to minority entrepreneurs.

Mr. CORNWELL. I will try to respond to your question, Senator. Speaking specifically about capital raising, I, as some of you know, had spent a number of years on Wall Street before deciding to take a vow of poverty and go into the broadcasting business. I was very surprised to discover how difficult it was going to be for someone, even with my background and with a lot of support from some very substantial people, to raise capital.

In fact, it was always sort of a joke within our office that the first banks we found who lent us money were all foreign banks; that we, for some reason, could not find an American bank that would lend us any money. As we have gotten larger and we have been more successful, we have had more success with American banks; and I am delighted, in case any of them are listening now, that they are all banking us today. But raising capital, Senator, has been very tough. The tax certificate gives us access to sellers, it gives them a reason to talk with us.

In our first transaction the tax certificate even motivated an individual to take 9 months to let us shop his deal, which no one does in the television business, so that we could raise the capital, because he knew we did not have the money when he signed the letter of intent with us.

I think, finally, I would just simply say that because we have been successful at negotiating better deals when we buy stations, I think our investors look at that as an important part of why they would invest capital with us. I hope that is responsive.

Senator MOSELEY-BRAUN. Finally, in Richmond, Virginia before the Crossand decision, minority contracting was about 35 percent; post-Crossand it went to 1 percent. What do you see is the effect of the elimination of 1071?

Mr. CORNWELL. If this question is directed to me——

Senator MOSELEY-BRAUN. It is open to whomever wants to respond.

Mr. CORNWELL. Yes. I would just simply say that I really think, particularly in an environment of deregulation where the rules are changing dramatically, there are fewer and fewer ownership restrictions with regard to broadcast properties. I think it is going to be incredibly difficult for new entrants to come into the business.

I might have said two weeks ago that I did not think Granite, my company, was going to be affected by the change in the tax certificate. And, while I would not want to come here and say this to you because I would love for you to allow us to continue in the tax certificate program, I must confess that over the last couple of weeks I have noticed that since Representative Archer made his announcement, our publicly-traded stock has been one of the worst-performing broadcast group stocks out there at a time when other broadcast group stocks, because of the deregulatory fervor, have gone up. So, I do think there is an impact on us, even in that regard.

Mr. JOHNSON. Senator, let me also add another issue that will happen. The tax certificate also allows minority station owners to sell to other minority buyers, so that you would perpetuate minority ownership if a minority would sell his station to another minority.

If the 1071 is repealed, since the minority will have to pay taxes, it is probably going to have to seek a higher buyer for his station and, with the access to capital problem, that buyer will probably not be another minority. So, you could see an effect, a roll-back in minority ownership rather than an expansion of it as a result of it.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you very much, Mr. Chairman.

Mr. Alarcon, let me ask you, what unique problems did you experience because you had a non-English language station.

Mr. ALARCON. Unique problems in terms of operating?

Senator BRADLEY. In terms of broadcasting. In other words, what problems do you face that are not faced by English-speaking broadcasters?

Mr. ALARCON. Well, I think, Senator, you have to understand that we are focusing our programming on a specific segment of the population with its own problems, for example, in terms of immigration, in terms of legal status, in terms of information regarding this country and how to succeed in this country.

I think that one of the benefits of this program is precisely that it allows people, such as myself, or the general managers or the program directors at our radio stations, to be able to speak to our constituency, if you want to call it that, directly about problems that are specific to them.

Senator BRADLEY. Now, you said that without a tax certificate you would not have been able to purchase the stations. Is that correct?

Mr. ALARCON. That is correct.

Senator BRADLEY. At the time you purchased the stations were there radio stations that broadcast in Spanish?

Mr. ALARCON. At the time we purchased our first station, yes, there was one. Excuse me. There were two.

Senator BRADLEY. But how many are there now?

Mr. ALARCON. Now there are three.

Senator BRADLEY. Let me ask you, do you think that the increase is related to the tax certificate?

Mr. ALARCON. Directly attributable, Senator. For example, in New York there was no FM station serving the Hispanic audience of over three million people in the New York City metropolitan area. Thanks to the tax certificate we were able to purchase the first-ever, and only to this day, broadcasting on FM in Spanish.

Senator BRADLEY. Mr. Horowitz, why do you think that there was not a radio station serving the Spanish population in New York?

Mr. HOROWITZ. Well, for one, as Mr. Alarcon said, there were. Second, we are really reaching a point where Hispanics have reached, happily, a position of status where advertisers are taking interest in——

Senator BRADLEY. No, no, no. Not now. Why then?

Mr. HOROWITZ. Well, as I say, at that time they were, perhaps, not identified as a community of people with enough money to be worthwhile to advertisers.

Senator BRADLEY. You mean, they could not get access to capital.

Mr. HOROWITZ. No, Senator Bradley. What I am saying is, it may well have been—and we do not know—that there were not John Malones to do for Mr. Alarcon what Malones did for Mr. Johnson. That reason may have had to do with some demographic sense of what the Hispanic market was.

But we are now talking about a powerful, multi-billion market and if bankers are dumb enough not to see the Alarcons out there and the profit potential, it does not seem to me that we ought to be spending $2 billion in tax write-offs to make up for dumb bankers and investors.

Senator BRADLEY. So you reject totally the access to capital argument?

Mr. HOROWITZ. Well, I think that it is, of course, true that when you start at the bottom and come from a community that starts at the bottom it is harder to get money. There is a wonderful Ogden Nash poem, bankers are just like everybody else, except richer.

Senator BRADLEY. Just to test your tax reform credentials——

Mr. HOROWITZ. Yes.

Senator BRADLEY [continuing]. Are you also in favor of eliminating like-kind exchanges of real estate transactions that defer taxes?

Mr. HOROWITZ. On the whole, Senator, without knowing the specifics of the program, absolutely.

Senator BRADLEY. So you would also be in favor of eliminating stock swaps which have the same effect.

Mr. HOROWITZ. Again, you are getting somewhat out of my league here in terms of the complexities of tax transactions. But to the extent you are talking about enormous tax simplification in exchange for low marginal rates, absolutely.

Mr. FEIN. And if I could amplify on the issue of whether or not——

Senator BRADLEY. I would like to ask Mr. Johnson if he would like to amplify.

Mr. JOHNSON. Would I what?

Senator BRADLEY. Would you like to amplify on the points that the minority-owned stations were five-tenths of a percent in 1978, and now they are 2.9 percent of the stations, and was that related to the tax certificate, and why at that time were there only five-tenths of a percent minority-owned?

Mr. JOHNSON. I think the clear reason why minorities are left out in all major industry segments that are capital intensive is because we are not at the table when these opportunities were made available due to racial and economic discrimination.

I mentioned to Senator Packwood when I met with him that when the Commission was giving out AM licenses, which used to be the dominant frequency, they would insist that some broadcasters, in order to develop the under-used FM band, take an FM license. It was part of the deal; you had to get two to take one.

We were not at that table. We were not in the room when those frequencies were handed out. And I could go throughout the history of this Nation when everything from oil leases, timber rights, mineral leases, you name it, we were not economically viable in terms of participation that economy.

You cannot come now to March the 7th at 10 after 12:00 and say, all right, everything is going to be equal now, everything is going to be race neutral, no more race consciousness.

If you do, in my opinion, you are going to doom black entrepreneurs to a system of where you are accepting some form of government subsidized handout, and I would rather not be in the government subsidized handout business, I would rather us compete on an equal basis with access to capital.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

I would like to focus specifically on the issue of cable TV. If the theory of this tax certificate is to encourage a diversity of voices, could someone talk to the application of that goal to cable television?

Mr. JOHNSON. Being in the cable business for almost 20 years, I started out as a lobbyist for the National Cable Television Associated and launched BET about 15 years ago, and I know just about every player in the cable industry. BET today is carried in about 40 million of the 60 million total cable households in the country.

I would make a strong argument that we ought to be carried in 60 million of the cable homes in the country. The reason we are not carried in the 60 million is because the owners of those other 20 million subscribers have simply decided that they do not want to expose their customers to black-oriented programming. I would argue, if the Frank Washingtons of the world and other minorities

owned those 20 million additional subscribers, BET would be carried, and perhaps other services.

I will give you another example. There are 60 million cable subscribers. Black Americans constitute, let us say, 10 percent of the subscriber base. That is six million subscribers. The average cost of basic cable today is about $30 a month. So, black Americans pay, on average, $180 million a year in money to the cable industry for access to cable. Over an annualized basis it is in excess of a $1 billion.

In spite of that fact, there is still only one black programming service, and that is BET. There is no black pay service, there is no black targeted service of any kind, to women, or whatever. The reason is simply because of lack of ownership. If you had more minorities owning cable systems, I can assure you they would ask for more black channels. That is my opinion.

Mr. FEIN. Senator Graham, if that were true, that if those owners of the cable stations refused to carry BET because of the race of the owner, that is clearly illegal under the current Federal civil rights laws, probably under most State laws as well, and would expose every one of those individuals to enormous liability, including punitive damages under the latest amendments to the 1991 Civil Rights Bill.

Senator BRADLEY. Would you take the case on a contingency basis? [Laughter.]

Mr. FEIN. Senator, what I would want to do is, unlike the Queen of Hearts making a sentence first and verdict afterwards, is take a survey of the facts beforehand.

Mr. JOHNSON. He is absolutely wrong. A cable operator has the right to choose, it is in the law, what programming they add to their systems. Now, we do everything we can marketing our program and product to them, but they make the ultimate decision.

I do not think you could go to court and come up with a prima facie case that there is racial discrimination because the system is not being carried. Some of the regulations imposed by the Congress can prevent it, for example.

So the whole argument here is, I think, Senator Graham, what you asked, does ownership lead to more sensitivity in programming decisions? It does it in every kind of media that I can think of. Whether you are running a cable system, TV system, or magazine, you are going to reflect the editorial base on your own particular bias.

Senator GRAHAM. Could I ask one last question?

The CHAIRMAN. Go ahead.

Senator GRAHAM. Is there some empirical evidence that there is a change in programming if you look at three periods of time preacquisition, assuming that the station had been owned by a non-minority prior during the period of minority ownership, and if there is a subsequent sale to a non-minority, is there empirical evidence that there is a difference in the programming of the cable TV station?

Mr. JOHNSON. I do not know if there is empirical evidence of any volume, because minorities own so few cable systems. But I can tell you that I own the cable systems in a partnership with TCI in

Washington, DC and in Denver, Colorado. And in both of those systems they program BET, obviously, so that is one example.

The other, is in terms of local origination programming. My cable operators also program local origination channels and, therefore, that programming reflects an interest on the part of the black community as well.

The CHAIRMAN. Mr. Brown, let me ask you a quick question. You were just starting to comment on wireless telephone licenses when I cut you off.

Mr. BROWN. Yes.

The CHAIRMAN. Where there is no programming content, what is the justification for a minority preference for wireless telephone licenses?

Mr. BROWN. It exists in Section 309J of the act that was enacted by Congress.

The CHAIRMAN. I understand that. Should it exist or should we repeal that? What I want is your philosophical justification, not your legal justification.

Mr. BROWN. The answer is, no, the Congress should not repeal that provision.

The CHAIRMAN. Why? What is the justification for a minority preference where there is no program content?

Mr. BROWN. What we are embarking in right now is selling a public resource. The public resource we are selling is the spectrum for this service, and will be sold for others under auction.

Minorities, women, and small businesses are the groups which get preferences, along with rural telephone companies under certain circumstances, and they traditionally do not have access to capital. That is the reason, I believe, why Congress included this provision.

The CHAIRMAN. And that argument reflects what most of you say, is the access to capital argument, and we will use the tax certificates to make up for the lack of access to capital.

Mr. BROWN. To the extent that the tax certificate is used for the minority ownership purpose. What I wanted to indicate to the committee also, because I think it is a matter of concern, is that the tax certificate is also there for relocation purposes for getting incumbents out of those frequencies. If that is not done, then this service is going to be long delayed before it becomes available and before the revenues become available to be taxed.

The CHAIRMAN. Senator Simpson.

Senator SIMPSON. Mr. Chairman, I thank you. Our task here is about extension of premiums, the extension of the health care insurance deduction. Personally, I would like to get to 100 percent, but that is back somewhere in the theme of how this all began, but we will not do that. But we have to extend this 25 percent health insurance for the self-employed by April 15th, and it is too late for some who have already filed by March 1st.

I just think it is very unwise to try to use a very controversial revenue raiser to pay for it, but yet it is difficult to feel sorry for the participants, kind of like baseball. Feeling sorry for Viacom and cable television is not something that kind of tugs your heart strings right off your body. So, that is something to recognize.

We all recognize that the goal of the program was to increase diversity in programming, and obviously that has worked because there has been a six-fold increase in the ownership of broadcasting stations by ownership from 0.5 to about 3 percent.

The thing I have a concern about, is that we are not getting enough bang for the buck, particularly in the cable transactions, where the tax benefit here may be hundreds of millions of dollars.

We are not talking about radio, which is certain millions, we are not talking about these other things. Yet it is virtually impossible to modify cable programming to reflect minority ownership. Where are we with that? I mean, am I missing something here? Or do you want me to rephrase it in my rambling, loopy way?

Mr. JOHNSON. Are you missing something in terms of cable ownership?

Senator SIMPSON. Yes. We all understand the issue of diversity in programming. But when you get to cable, I mean, you are into the big bucks, you are not into the $3 million or the average one getting this amount. When you are talking about relief for a company of $1.5 billion you are up in a new league.

Mr. JOHNSON. Well, I think you are, but we have talked about the fact that Viacom, and TCI, and Frank Washington are smart enough to create a transaction that would avoid taxes if they wanted to.

But I think, on the question of cable, I would argue it is probably more important for diversity that you get minority ownership in broad band technology because broad band technology is going to be the information super highway technology of the next decade and beyond and someone is going to have control over a multiplicity of distribution outlets. And if you do not have minority ownership in that you may be, in effect, taking more control out of the hands of the opposing points of view rather than encouraging it.

So, I would think that the transactions are going to be larger and the tax benefits are going to be larger, but that is the nature of an industry where you have got telecommunications, telephone, and cable all converging, the economies are going to be great.

Senator SIMPSON. Well, I think that it would be well, and there have been restrictions, obviously, legislatively on the FCC and what they can do. Maybe we ought to let them try to resolve this at this time and get our tax, 25 percent health insurance deduction out here on the road and deal with these other things.

But I have some grave concerns about the use of the certificates, of saying that we have to continue something which is something I think we have all got a little out of whack for me now as to what we were really trying to do and who we were trying to benefit. I think we have lost our course.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moseley-Braun. Excuse me. Senator Moynihan. I apologize.

Senator MOYNIHAN. Mr. Chairman, if you are going to hear Mr. Washington, Mr. Dauman, and Mr. Huhndorf, you are going to have to finish.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. I concur.

The CHAIRMAN. Senator Graham?

22-843-0-3

Senator GRAHAM. No questions.

The CHAIRMAN. Gentlemen, again, thank you very, very much for a most informative panel. We will go on with the next panel because I fear we have so many votes possibly scheduled this afternoon I do not know when we would get to the panel.

Again, we will take you in the order that you are on the witness list. We will take Mr. Philippe Dauman first, who is the executive vice president and general counsel for Viacom.

STATEMENT OF PHILIPPE DAUMAN, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, VIACOM INC., NEW YORK, NY

Mr. DAUMAN. Thank you, Mr. Chairman.

Viacom is a publicly-traded company whose common stock is widely held by more than 40,000 stockholders. I welcome the opportunity to testify today in opposition to the retroactive effective date in Section 2 of H.R. 831, a retroactive provision aimed with laser-like precision at targeting and killing the legal, above-board, and widely-reported sale of Viacom's cable systems to RCS Pacific.

Mr. Chairman, I wish to stress this point. We acted in full reliance on the rules created by the FCC and ratified by Congress. Section 1071 was enacted into law in 1943. It was expanded by the FCC to include the sale of broadcast stations to minority-controlled companies in 1978 and further expand it to cover sales of cable systems in 1982 during the Reagan Administration.

Moreover, to underscore support of the program Congress has annually, for 8 years, legislated to prohibit the FCC from limiting the scope of the tax certificate program.

The CHAIRMAN. Let me indicate, I am going to have to ask you to stay within your 5 minutes, so you want to get to the point that is critical.

Mr. DAUMAN. I am summarizing my points.

The CHAIRMAN. All right.

Mr. DAUMAN. It did so in 1987, it did it again in 1988, it did this in every subsequent year, right through the most recent action in August 1994. Against this backdrop, Viacom commenced negotiations with Mr. Washington and InterMedia, in June of 1994.

We proceeded to enter into what became a complex and lengthy set of negotiations. The negotiations, all drafts, and the final agreement were premised and conditioned on the sale qualifying under the Section 1071 program.

As shown in the chronology accompanying my written testimony, the first draft of an asset purchase agreement was circulated among the parties on July 24th.

The Viacom board initially approved the transaction on August 18th, virtually the same day Congress again barred changes to the policy, and initial financing commitments were obtained by the purchasers in mid-September.

On October 1st, we announced stay bonuses for over 150 employees in Viacom Cable in an attempt to retain employees unsettled by the sale discussions.

On December 14th, the Viacom board approved the final business terms of the sale. By January 14th, all principal legal terms of the sale agreement were agreed to, and six days later, on January 20th, the final agreement was signed by all the parties.

As of January 14th, Viacom and the purchasers had incurred in excess of $15 million in actual out-of-pocket costs on this transaction. This does not include the thousands of hours of employee time spent putting this transaction together, or incalculable lost opportunity in human resource costs involved.

It is worth noting that, as often happens in our industry, the sale of Viacom Cable is extensively discussed in the press. On August 15, 1994, a detailed article appeared in the trade journal Multichannel News, and a similar article appeared in The Wall Street Journal.

Both of these articles noted the seller to be a tax certificate transaction and identified the purchasers. Additional articles discussing impending sale appeared throughout the remainder of 1994.

At no point during this entire period did any government official, whether in executive or legislative branch, either on or off the record, express any concern about this transaction. Although large, the transaction was and is structured the same as many preceding 1071 transfers approved by the FCC.

In short, Viacom and the purchasers spent 7 months and millions of dollars putting this sale together in reliance on longstanding Federal policy. To adopt a retroactive provision specifically killing this transaction is, we submit, a major inequity against our company and its shareholders, and would expose transactions of all kinds to the fear that some future Congress would adopt targeted retroactive legislation.

We believe that no matter how large or small a taxpayer is, respect for the tax system can only be gained if the rules are consistently and fairly applied. It has been publicly stated that the revenue estimate on this matter assumes the government will gain $500 million or more from Viacom if Section 1071 is retroactively repealed. This is simply not true.

There are no capital gains revenues to be generated from this transaction by retroactive repeal because this sale will not occur. If Viacom had to pay capital gains taxes on this sale, our net proceeds would be less than the net present value of our current yield from the existing cash flow of the cable systems.

Simply put, a taxable sale would result in a financial loss for Viacom. Accordingly, it would economically hurt Viacom and its stockholders to proceed with a taxable sale and, therefore, we will not. As Senator D'Amato said, we are not stupid.

Parenthetically, we are not aware of any large cable transaction in recent years which contain a significant taxable component. Tax policy today permits taxpayers to construct tax-free transactions, such as stock swaps, without showing tax consequences. For example, Time Warner has announced almost $5 billion in non-taxable cable acquisitions in the six weeks since our sale agreement was signed.

We also reject the view that the House-passed bill is not a retroactive change because Viacom was somehow on notice as of a January 17th unilateral Ways and Means Committee press release indicating that the law might be changed.

The fact is, as I have stated, the sale was, for all intents and purposes, completed except for final legal documentation before Janu-

ary 17th. It was a done deal. In fact, the press release itself was response to media reports that the Viacom Cable sale was about to be consummated.

Subsequent to the press release, no legislation was introduced to change or appeal Section 1071 till the evening of February 6th, the eve of the Ways and Means mark-up and well after our documents were signed.

Mr. Chairman, I will close with one final comment. This is a legitimate sale to a minority-controlled partnership with conservatively fits within the four corners of existing government rules governing tax certificates.

We are certainly aware of the political revolution which took place last November and we acknowledge the proper role of Congress to change tax policy, but we submit that it is unfair and wrong, and sends a destructive message to the private sector, to adopt a retroactive effective date for the apparent purpose of penalizing a particular transaction into less specific——

The CHAIRMAN. Mr. Dauman, we are familiar with retroactivity. I am going to have to ask that you stop.

Mr. DAUMAN. Thank you, Mr. Chairman.

[The prepared statement of Mr. Dauman appears in the appendix.]

The CHAIRMAN. Mr. Washington.

STATEMENT OF FRANK WASHINGTON, PRESIDENT, MITGO CORPORATION, SACRAMENTO, CA

Mr. WASHINGTON. Thank you, Mr. Chairman. I welcome this opportunity to appear here and present the facts related to my acquisition of the Viacom Cable properties. Before turning to the Viacom acquisition, let me briefly describe how I came to be here today.

I was born in this city in 1947. My father was a manual laborer, my mother a secretary. My father, who is buried in Arlington Cemetery, died when I was 12. I put myself through Cornell University and Yale Law School. I am the only person in my extended family of birth to receive even an undergraduate degree.

After practicing as a communications lawyer at Arnold & Porter here in Washington, I joined the Office of Telecommunications Policy in the White House in 1977. By 1978, I was a legal assistant to then FCC Chairman, Charles Ferris when the Commission enacted the tax certificate policy for radio and television stations.

In 1981, I left government and became a vice president with Times Mirror's Cable Division. Not until a year after I left Washington in 1982 did the FCC, under Reagan appointee Chairman Mark Fowler, extend the minority tax certificate policy to cable.

In 1984 I was hired by McClatchy Newspapers to manage their cable systems, with more than 100,000 subscribers, as well as other communications operations. Although the cash flow of those businesses was increased under my supervision, McClatchy decided to dispose of the properties.

In 1987 I decided to leave McClatchy with the single-minded purpose of buying and running my own cable systems. It took over 2 years, the review of scores of deals, all my personal savings, the proceeds from the sale of my house, the dissolution of my marriage,

and the help of the tax certificate program before I completed my first deal in 1990.

Today I own and operate systems with 440,000 subscribers in eight States. I continue to own every cable system I ever purchased and I operate them with a high level of commitment to my customers. I acquired those systems with affiliates of InterMedia Partners, an investment partnership led by Mr. Leo J. Hindery, Jr.

Recent changes in technology and telecommunications policy ensure that the cable industry will soon encounter significant competition from, most formidably, the Bell Operating Companies. Thus, I have concluded that geographical consolidation and the overall growth of our cable holdings are imperative for my business to succeed. Only in this fashion can I match my opponent's economies of scale.

Knowing that Viacom operated cable systems serving subscribers in areas of the country where I and/or InterMedia already had cable systems, we proposed that they sell. The negotiations began in earnest in July of 1994 and effectively concluded in late December. The price is around $2,061 per subscriber, which is consistent with the $2,046 per subscriber average price of the eight other largest cable deals announced since June 1994.

On January 20, 1995, RCS Pacific LP entered into a definitive acid purchase agreement to acquire Viacom's cable systems. RCS is a limited partnership with two partners: Mitgo, my company, and InterMedia Partners. Mitgo will own and is responsible for funding 21 percent of the equity of RCS and is the managing general partner. InterMedia Partners will own 79 percent of RCS and be the limited partner.

I own 100 percent of Mitgo and will continue to control personnel, programming, pricing, franchising, capital expenditures, financings, and all other significant decisions. Under the terms of the contract I must remain in the deal for at least 3 years.

H.R. 831 was introduced on February 6th. It would repeal Section 1071, effective retroactively to January 17, 1995, the date of Chairman Archer's press release. However, by January 17th, my transaction had already been in negotiations for 7 months. Significantly, each of the events key to this deal occurred in 1994, well prior to the effective date contained in the legislation.

I am not questioning the propriety of Congressional review of the tax certificate. While I oppose repeal of the policy, I do not oppose changing the policy. However, the singling out of my deal for retroactive application and the haste with which it was introduced and passed by the new House both troubles and befuddles me.

I am shocked that the first piece of tax legislation was a retroactive tax increase targeted to stop a single transaction. All I ask for is simple fairness and the opportunity to compete. Thank you.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Washington appears in the appendix.]

The CHAIRMAN. Mr. Huhndorf.

STATEMENT OF ROY M. HUHNDORF, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, COOK INLET REGION, INC., ANCHORAGE, AK

Mr. HUHNDORF. Mr. Chairman and members of the committee, thank you for allowing me to testify. My name is Roy Huhndorf and I am chairman and CEO of Cook Inlet Region, Incorporated, also known as CIRI.

I am honored to present to you our view on the minority tax certificate program administered by the Federal Communications Commission. I have submitted my written testimony which I will summarize for you.

CIRI is an Alaskan Native corporation owned by approximately 6,700 Native Americans of Athabaskan, Eskimo and Aleut descent. Over the past decade, CIRI has been recognized as one of the Nation's leading minority-owned broadcasters and the largest Native American-owned broadcaster. Until recently, CIRI owned 11 radio stations and two television stations.

CIRI has utilized the FCC's minority tax certificate program and in so doing has consistently and demonstrably upheld the Commission's minority ownership policies. We like the tax certificate concept because it is a private sector, self-help program.

In the spirit of what we think was intended by Congress, CIRI, in utilizing the tax certificate, has committed real equity capital commensurate with the size of the deal, we have exercised real control, we have committed significant resources to diversify the viewpoint and involvement in the community in which it serves, and we have had long ownership periods averaging over 7 years.

We believe that there are other equally bona fide minority-owned companies that have utilized the tax certificate in a similarly legitimate way, but we believe there are those who would seek to bend the rules.

CIRI has had a history of protesting such transactions. In 1993 we protested the Times Mirror transaction on that basis. Again, we have filed a protest of the Viacom proposal.

CIRI urges the Committee and Congress to direct the FCC to eliminate these abuses of the program. Specifically, we recommend that five key steps to reform the tax certificate program be made.

First, the program should be made more race-neutral and economically based by requiring that the entity not only be an underrepresented minority group, but also disadvantaged. Second, the disadvantaged entity should have clear and actual control over the purchasing entity. Third, the disadvantaged entity should have a real equity stake in the enterprise. Fourth, certain hallmark elements in an organizational structure which call into question the minority partner's current and continued involvement in the entity should disqualify the entity. Mechanisms such as puts and calls should disqualify the entity.

Finally, the Commission should make clear in writing that, if the purchasing entity statements are found to be false, incomplete, or misleading, the entity and its principals will be subjected to substantial penalties as well as being disqualified from applying for any Commission licenses in the future.

A rigorous application of the FCC's criteria will eliminate shams and limit the program's effect from a tax revenue standpoint. To

cap the tax certificate application would limit qualified minorities to opportunities in only the lower tiers of communications markets.

The tax certificate program administered by the FCC has tremendous importance and potential but, due to lax Administration, the program has suffered from significant abuses and erosion of credibility.

This concludes my testimony, Mr. Chairman. I would be happy to answer questions.

[The prepared statement of Mr. Huhndorf appears in the appendix.]

The CHAIRMAN. Just out of curiosity, Mr. Huhndorf, on your qualifications, economically disadvantaged, a real control over purchaser, real equity stake, and not borrow a significant portion, apart from two or three of the previous panel, and maybe Mr. Washington, who have made it, can you think of another group in America other than yours that would qualify under those terms as new applicants, not somebody who has finally arrived in the business and can probably borrow money or have their own equity?

Mr. HUHNDORF. Mr. Chairman, we believe that possibly aggregations of disadvantaged minorities could qualify. CIRI, in effect, is an aggregation.

The CHAIRMAN. But the aggregations have to have the equity stake, they cannot be borrowing the money.

Mr. HUHNDORF. Yes, indeed.

The CHAIRMAN. You have got to have aggregations of minorities that have real cash assets, not borrowing, but assets.

Mr. HUHNDORF. And I believe that it is possible, Mr. Chairman, if the aggregation were large enough.

The CHAIRMAN. It is not a question of large enough, it is a question of finding the minorities that are in that kind of an asset position that will not have to borrow. Mr. Washington, can you think of very many that are in that position?

Mr. WASHINGTON. I was perplexed by the same question that you are asking.

The CHAIRMAN. All right.

Mr. Dauman, let me ask you a question. I have got this sequence here of everything you have gone through from August onward. January 17, 1995 there is the Ways and Means press release, and indicating that any legislation may be effective to the date of the press release, and the hearings are 10 days later, and the mark-up is on February 8th, and it goes back to January 17th.

On January 16th was this a done deal with you and Mr. Washington or could either of you have gotten out of it; was it a completed contract or not?

Mr. DAUMAN. The contract was essentially done. In fact, the final agreement, I had that compared to the agreement as it stood before the press release, and there were a grand total of seven insignificant, non-substantive changes in the 79-page agreement from before that press release and the final signed version. In fact, I believe the press release was caused by press reports that our deal was about to be signed.

The CHAIRMAN. But either you or Mr. Washington, therefore, have sued and got that contract enforced on January 16th.

Mr. DAUMAN. I have not explored that question, Mr. Chairman.

The CHAIRMAN. This becomes very key as to whether this was a completed contract or not.

Mr. DAUMAN. Mr. Chairman, we signed the contract three days after the press release. We did not have a signed contract on the date of the press release. But, again, I would say the press release, which was issued by the Chairman of the House Ways and Means Committee, it was not a Joint Committee release, stated only that the law be looked at and that it might be changed. And again, we had spent 7 months and essentially it was a done deal. Legally, we signed the agreement on January 20th.

The CHAIRMAN. Was it an enforceable deal on January 16th?

Mr. DAUMAN. I do not believe that it was enforceable until it was signed. Had we refused to sign, could the purchasers have maintained an action against us for not carrying out an agreement where we had all essential terms of the deal done? I just have not explored that question. That would be a question for the courts to determine.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I think that is the question and I think Mr. Dauman has given a very forthcoming, open response. I think we may want to get some legal advice within our own facilities and resources here to resolve what is the central question.

I thank you, Mr. Dauman, Mr. Washington, Mr. Huhndorf.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much.

Mr. Washington, would you have been able to put this deal together with Viacom in the absence of the tax certificate?

Mr. WASHINGTON. Absolutely not.

Senator MOSELEY-BRAUN. Will you be able to go forward with the deal if the tax certificate repealer is made retroactive, as the House suggests that it is?

Mr. WASHINGTON. I will not only not go forward, I will probably go backwards, out of the business.

Senator MOSELEY-BRAUN. Why?

Mr. WASHINGTON. Because, as I explain in my testimony, the cable industry is going through a drastic retransformation. It is anticipating very, very significant competition from the likes of the Bell Operating Companies.

In order to be able to meet that competition we have to have the kind of size, mass, and co-locations of systems that puts us sort of in the same ballpark. That is the decision that I am facing.

It is the same decision that, if you read the front page of the Wall Street Journal, you will note that almost every other week there is a transaction where someone else is leaving the business.

It is a reflection of a fact that at this point you either have to buy to amass enough size to meet that competition or you have to seriously consider getting out or watching the deterioration of your assets. I sit squarely in that position right now. If I cannot do this deal and the tax certificate is repealed, I am probably going to be faced with a decision to leave the business.

Senator MOSELEY-BRAUN. So I guess the question becomes then, in the absence of your going forward with this deal—Viacom, I presume, is still interested in spinning off its cable transactions—in

all likelihood you would go into a tax-exempt or a tax-free, tax-neutral arrangement with someone else.

Mr. DAUMAN. Obviously, Senator, if I were unable to go through with this transaction we will have to explore other possibilities. We had wished to reconfigure our assets, is what this was all about. We have publicly said we are a software-driven company. That was the reason that we explored the sale of our cable system to Mr. Washington. But we will not be able to go through with this sale if the Section 1071 program is retroactively repealed, for the reasons I stated earlier.

Senator MOSELEY-BRAUN. So then the net effect of all of this legislative going on would be to retroactively kill Frank Washington's ability to go into business and kill the benefits to the public that the tax certificate program has meant, all to no particular end other than to roll back the gains that our communities stand to benefit from having minority involvement in broadcasting.

Mr. DAUMAN. It would also, I might add, for Viacom, create tremendous harm to our company and its many shareholders.

Senator MOSELEY-BRAUN. How so?

Mr. DAUMAN. Well, we have, again, devoted money, we have devoted a lot of management time, we have directed our strategy toward the effectuation of this transaction and redeployment of our assets. And if we cannot go through with this it will slow us down considerably.

It will create great uncertainty for our company, for our employees. Again, we have lost many employees in our Viacom Cable division. The passage of the House bill has created more turmoil and we are having a difficult time just managing our cable systems right now.

Senator MOSELEY-BRAUN. Thank you.

The CHAIRMAN. Senator Murkowski.

Senator MURKOWSKI. Thank you very much, Mr. Chairman.

For Mr. Huhndorf, you indicated that the Federal Communications program could only be available to economically disadvantaged groups. If they cannot raise their own capital how can they purchase stations?

Do you think that the current program, which, as we have seen on specific occasions, benefits wealthy minorities is a proper use of the Tax Code? I mean, we have the Bill Cosby's, the Oprah Winfrey's, and others using this program.

Mr. HUHNDORF. I would qualify my statement by saying that I would have in mind rules promulgated by the FCC that would take into consideration levels of disadvantagement, not necessarily adopting, for example, the SBA's 8A standards, but instead tailoring its own so that at least there can be a screen to run people through that determines how disadvantaged, how well-off they really are or are not, and make that a qualification for the program. That is what I meant to suggest in my testimony.

Senator MURKOWSKI. Mr. Washington, as I understand this deal, you cannot basically make the deal without the tax subsidy.

Mr. WASHINGTON. Tax certificate. Correct, sir.

Senator MURKOWSKI. And, as a consequence, the deal would not be made with you, it would be made, perhaps, on a stock exchange or something else that would not have a tax consequence.

Mr. WASHINGTON. If it were going to be done at all.

Senator MURKOWSKI. Yes. I am told that this involves some $2.3 billion. Can you tell us how much money you have put up?

Mr. WASHINGTON. I am purchasing my 21 percent of the equity.

Senator MURKOWSKI. Well, that does not answer my question. How much money are you putting up?

Mr. WASHINGTON. Several million dollars, sir. I am getting the rest by borrowing it from independent third sources.

Senator MURKOWSKI. How much is several million dollars? You are familiar with this so you know in millions. Is it $5 million, $2 million?

Mr. WASHINGTON. It is in excess of $2 million of my own money.

Senator MURKOWSKI. In excess of $2 million and under $3 million.

Mr. WASHINGTON. Correct. And I would——

Senator MURKOWSKI. Of your own money.

Mr. WASHINGTON. Correct. And I would add to that, money which I intend to borrow from independent third sources.

Senator MURKOWSKI. And that would be the balance of the cash put up, it would be borrowing.

Mr. WASHINGTON. Right.

Senator MURKOWSKI. So you are pretty highly leveraged.

Mr. WASHINGTON. Well——

Senator MURKOWSKI. It depends on your point of view. I understand.

Now, there are puts and calls that can be exercised after 3 years that would allow you to leave the company or could allow your partners to buy you out, right?

Mr. WASHINGTON. That is correct.

Senator MURKOWSKI. Can you explain why these provisions were specifically included in this agreement?

Mr. WASHINGTON. Well, I think you will find that a lot of agreements of this nature have those kinds of clauses in them. It is not that unusual.

Senator MURKOWSKI. No, but certainly advantageous.

Mr. WASHINGTON. Right.

Senator MURKOWSKI. It is good business.

Mr. WASHINGTON. Well, that is right.

Senator MURKOWSKI. All right.

Mr. WASHINGTON. And I think the thing to focus on is that those kinds of clauses have been in the other agreements that I——

Senator MURKOWSKI. Other minority agreements.

Mr. WASHINGTON [continuing]. Have used the tax certificate on and I have never either put, or has there been a call, and we are talking about some of those agreements going back as much as 5 years.

Senator MURKOWSKI. My last question is, I understand that Telecommunications, Inc., one of your limited partners, is going to be providing a large share of the financing for this transaction. Is that correct?

Mr. WASHINGTON. For the overall transaction. But you have to understand, I am putting in my own money independent of that.

Senator MURKOWSKI. Putting in under $3 million. But is it fair——

Mr. WASHINGTON. No. In addition to that I am also going to be borrowing money from other——

Senator MURKOWSKI. I understand. I am talking about equity, and it is under $3 million, you have indicated. I understand Telecommunications, Inc. is providing a very large share of the financing for the transaction. Is that correct?

Mr. WASHINGTON. Well, who are you referring to?

Senator MURKOWSKI. Telecommunications, Inc., one of your partners.

Mr. WASHINGTON. Oh. TCI. Right. That is correct.

Senator MURKOWSKI. How much are they loaning?

Mr. WASHINGTON. I am not absolutely sure of this because the deal is still at a point where we are trying to pin down the exact structure.

Senator MURKOWSKI. All right. So you do not know yet.

Mr. WASHINGTON. Well, it is a large amount of money. I will tell you that.

Senator MURKOWSKI. What is a large amount?

Mr. WASHINGTON. More than half a billion.

Senator MURKOWSKI. More than a half billion.

Mr. WASHINGTON. Right.

Senator MURKOWSKI. And what share of the cable market do they represent?

Mr. WASHINGTON. I could not tell you off the top of my head.

Senator MURKOWSKI. Would you provide that for the record?

Mr. WASHINGTON. I would be happy to.

Senator MURKOWSKI. Thank you, Mr. Chairman.

[The information appears in the appendix.]

The CHAIRMAN. Senator Moynihan?

Senator MOYNIHAN. No questions. Great thanks to our panel, which was very open and informative.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you, Mr. Chairman. Again, I want to thank you particularly for the tone that was set for this hearing. I think it certainly was in the right direction and allowed for complete discussion and exploration of the issues in a manner that I think does real credit to this committee. Thank you.

The CHAIRMAN. Thank you very much.

Gentlemen, we are adjourned.

[Whereupon, at 12:50 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF RAUL ALARCON, JR.

Mr. Chairman and Members of the Committee:

My name is Raul Alarcon, Jr. I am the President and Chief Executive Officer of Spanish Broadcasting System, Inc. I greatly appreciate your offer to testify today concerning the proposed repeal of Section 1071 of the Internal Revenue Code, and the impact of this action on the Hispanic community. As you know, the Federal Communications Commission's Section 1071 tax certificate program, among other things, allows radio broadcasters to defer taxes on the sale of their stations when the stations are sold to qualified minority buyers and the proceeds of the sale are reinvested in other communications properties. I urge you to oppose repeal of this important program.

Spanish Broadcasting System is a family-owned and operated company, founded in 1983. My father, one of the founders of SBS, was born in Cuba, as I was. At the time of the Cuban revolution, he owned a chain of radio stations that were seized by the Castro government. We came to this country as refugees, with very few possessions. We became United States citizens, and for the next twenty years my father worked his way up in Spanish-language radio, working jobs in programming, sales, and advertising. Finally, more than twenty years after we left Cuba, my father and his Hispanic partners were able to purchase a small AM radio station licensed to Newark, New Jersey. The owners, all Hispanic, mortgaged everything they had to buy this station.

That was 1983. Today, we are the largest Hispanic-owned media company in the United States. SBS owns and operates seven radio stations in major markets: WSKQ-AM and FM serving Northern New Jersey and New York City, KXED-AM and KLAX-FM in Los Angeles, WCMQ-AM and FM serving Miami, and WZMQ in Key Largo. Every one of these stations provides Spanish language programming. Every one of these stations was purchased with a tax certificate.

Two weeks ago, the House of Representatives voted to repeal Section 1071 outright. Not to amend it. Not to reform it. To repeal it. I believe that vote was a mistake. Let me explain why.

In my view, the vote in the House of Representatives reflects a deep misunderstanding of the tax certificate program and of the radio broadcast industry. In my view, far too much attention has been given to the impact of the tax certificate program on the sellers and buyers of radio stations—and far too little attention has been given to the impact of this program on the minority community.

The tax certificate program has its roots in the unique character of the broadcast industry. Because the radio spectrum is limited—and because the technology to access the spectrum is limited—there are a finite number of radio licenses, only a fraction of which are available to buyers in any given year. Unlike virtually any other business in this country, you cannot get into the radio broadcast industry at will. If you can raise the capital to open a restaurant, or a dry cleaners, or a shoe store, you can go into business right away. But if you want to own and operate a radio station, you must raise the capital—and you must find someone who is willing to sell you the station.

For minority buyers, such opportunities are few and far between. Radio stations in major markets range in price from $40 million to $150 million. The FCC's decision in 1992 to relax its ownership restrictions has made it possible for some broadcasters to buy second, third, and even fourth stations in markets previously closed to them. This change in the rules has created a new group of large, well-financed bidders for available licenses—and has foreclosed many market opportunities for mi-

norities. Even if a minority buyer can raise the money to buy a station, the minority buyer must compete with established companies, some of them media giants, that can offer sellers tax-advantaged deals—such as tax-free asset swaps or tax free stock exchanges—that enable the seller to defer tax on the gain from the sale. In this environment, the FCC tax certificate merely levels the playing field.

In addition, fearful that financing will not be forthcoming and that sales will not go to closing, sellers are often reluctant to sell to Hispanic buyers because—anticipating changes in format from English to Spanish-language programming—they fear disruption among their staff, advertising community, and listeners during the six month regulatory review process. The tax certificate provides an incentive for the seller to endure such potential hardships.

Therefore, although the direct benefit from the tax certificate goes to the seller, and not the buyer, the fact of the matter is that there are other, tax-advantaged ways for broadcasters to sell radio stations that have nothing to do with the minority tax certificate. The benefit to the minority buyer is that the tax certificate gets the minority buyer to the bargaining table by enabling the minority buyer to offer similar tax advantages to a seller. Our company—SBS—has paid market price for every station that we purchased—but—for the reasons stated above—we could not have purchased one of these stations without a tax certificate.

We know, therefore, on the basis of our experience, that the tax certificate program works. It is a voluntary program. It works without mandates, without setasides, without quotas. It does nothing more than encourage sellers to sell to minority buyers—and it lets the marketplace do the rest.

And the marketplace is tough. In 16 years there have been only a little over 300 properties bought and sold with tax certificates. Some say that this is evidence that the program is of little value. They are wrong. This is evidence of how tough the marketplace is for minority buyers—even with the tax certificate. Take the tax certificate away, and the number of purchases by minority buyers will all but disappear.

In your invitation to testify, you asked about possible alternatives to make capital available to minorities who wish to acquire media properties. I would welcome such programs—and I invite Congress to consider the merits of programs that would provide low-cost financing to minority buyers, or that would encourage investors to invest in minority broadcasters. But, given the nature of the broadcast industry, with its unique barriers to entry, and the advantages that the tax system affords large corporate buyers, such programs could not be an adequate substitute for the tax certificate program.*

Why is the tax certificate program worth saving? It is worth saving if we care about diversity in the broadcast industry. It is worth saving because minority owners offer the single best hope and opportunity for bringing new voices, new viewpoints, to the broadcast industry, and new entrepreneurs into the mainstream of this country's economy.

Our New York area stations were English-language stations before we bought them. We were the first—and are still the only Spanish-language FM station in New York City, a market with 3 million Hispanic listeners. Today, our New York station is the fifth-ranked station in New York—the first foreign-language station to break the Top Ten in New York City's history. If Hispanic ownership doesn't make a difference, why was there no Spanish language FM before ours?

Our Los Angeles stations were English-language stations before we bought them. Today, they are Spanish, and our FM station is the number one-rated station in Los Angeles, beating out all other English and Spanish-language competitors. Our South Florida stations are strong in a highly competitive market. How can we account for such success? We serve the community.

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*The FCC's distress sales policy is sometimes cited as an alternative means for increasing minority ownership of broadcast properties. The distress sales policy allows broadcasters at risk of losing their license to sell their stations instead to qualified minority buyers at 75% or less of the station's fair market value. The distress sales policy cannot substitute for the tax certificate. First, few stations are threatened with license revocation in any given year, and fewer yet are designated for a revocation hearing. Second, of the small number of stations scheduled for revocation hearings, even fewer are found in markets with sizable minority audiences, let alone Hispanic audiences. Between 1978-1994, only 42 distress sales were approved—on average, less than four a year. Indeed, there is no guarantee in any given year that there will be any stations available for distress sales at all. See, *In the Matter of Policies and Rules Regarding Minority and Female Ownership of Mass Media Facilities*, FCC 94-323 (Released January 12, 1995), at 4.

Who benefits from the tax certificate?

First, our listeners benefit. We provide music, news, sports, and public affairs programming to our audience that the mainstream media does not provide. We understand this audience. We know the Hispanic audience is not a monolith. The Hispanic audience is diverse and complex. The programming we provide to our listeners in Southern California, with a large Mexican-American and Central American population, is different from the programming we provide in New York City, with a large Puerto Rican and Dominican-American population, and different yet from the programming we provide to our listeners in South Florida, with a large Cuban-American, and South American audience. No mainstream broadcasters speak to this audience the way that we do nor, in our view, are they capable of doing so.

Second, the Hispanic community at large benefits. We are involved in the communities where we have stations. Our stations have won dozens of community awards. We have sponsored hurricane and earthquake relief projects, and toy drives for needy children. During the Gulf War, when Hispanic-American soldiers fought in great numbers for the United States, we devoted hours of programming to war reports. Our AM stations dedicate morning news blocks to national, local, and regional news of special interest to the Hispanic community.

Third, Hispanic workers benefit. The tax certificate program has been an important force in increasing the number of jobs in the broadcast industry for minorities—jobs in management, in finance, in advertising, as announcers and disk jockeys, and in administrative positions. I dare say that our FM station in New York City employs more Hispanics in key positions than all other FM stations in New York. We also provide a showcase for Hispanic musical talent. And, to the extent we boost the business of our advertisers, we help create new jobs in the community as well.

Fourth, the business community benefits. Our stations are a tremendous resource for the Hispanic business community—and for local and national advertisers that want to speak to the Hispanic audience. Our stations do business with hundreds of Hispanic vendors into the millions of dollars, and we provide our advertisers with access to markets that, in many cases, were beyond reach until we purchased our stations and converted them to Spanish-language programming.

All of these people—literally millions of people—are beneficiaries of the tax certificate program. In this sense, the tax certificate program is a true "empowerment" program. Is it cost-effective? We think so. We believe that the tax deferral on the stations we have purchased is yielding benefits every day for our listeners, for Hispanic workers, for Hispanic businesses, and for the Hispanic community.

Finally, in your invitation to testify you asked whether the tax certificate program should be continued in its present form, modified, or repealed.

I hope it is clear that I strongly oppose repeal. I recognize, however, that the program is not without its critics, and that some of the criticism may be justified.

I am the President of a 100% Hispanic-owned company that has, in my view, served the highest goals of the tax certificate program. We actively manage and control the day-to-day operations of our stations. We have never sold a station. With much hard work we have tried, with considerable success, to bring a new Hispanic voice to the broadcast industry. I hope you will understand, therefore, when I tell you that no one could be more offended than I am by the stories of persons who have abused the tax certificate program in search of a quick profit. I firmly believe, however, that such stories are the exception, rather than the rule. Repeal is wrong. For every so-called sham transaction repeal blocks, it will also block scores of legitimate transactions. But I am not opposed to efforts at addressing problems that have been identified in the administration of Section 1071, and I will gladly work with the Committee to find solutions to these problems.

Let me suggest some reforms for your consideration.

- Increase the holding period: By requiring buyers to hold stations for a minimum of three years, with appropriate sanctions for early sales, Congress could help ensure that the program only attracts buyers that are committed to serving the industry and the community;
- Prohibit buyouts: By disqualifying transactions that give a non-minority buyer the right to repurchase the property from the minority buyer, Congress could protect the public interest in preserving diversity once a sale has been made, and discourage sales to so-called "fronts" for non-minority buyers;
- Transfer administration to the IRS: Recognizing that the program has been criticized because it is administered by the FCC, Congress could transfer administration of the program to the Internal Revenue Service. (I would recommend, however, that Congress continue to require the FCC to certify that a sale meets the FCC's criteria for minority purchases.)

- Codify the minority ownership rules: Congress could codify the FCC's minority ownership rules, insuring Congressional oversight and setting the parameters of the program by law.
- Cap the amount of the tax deferral: I believe that the claimed revenues from repealing Section 1071 are greatly overstated, since many sales will never take place without Section 1071, and still others will proceed under some other tax-advantaged program. Moreover, as other commentators have noted, the program provides for a deferral, not a forgiveness of tax. Nevertheless, if you deem it appropriate to do so, Congress could cap the amount of tax that qualifies for deferral under Section 1071.

  A cap would minimize the revenue loss attributed to the program. But the cap must be set at a realistic level, I would suggest $50 million, in order to permit minority buyers access to the major markets where minority audiences are found. Given the low tax basis of many stations, a low cap, I respectfully suggest, could destroy the viability of the program, since it would foreclose opportunities for minority buyers to compete in the top 20 markets.
- Direct the FCC to study the program: Given the criticism of the tax certificate program, it would be appropriate for Congress to direct the FCC to study the program and report on the results of the study. At the very least, before Congress repeals a program that has achieved demonstrable success with companies like SBS, it is important to have the facts.

Whatever action you take, I urge you not to repeal Section 1071, which has played a critical role in bringing diversity to the broadcast industry. We want to grow, and we want other minority-owned companies to have the same opportunities that we had. I thank you for your attention to my testimony and for this opportunity to testify. I welcome any questions you may have.

Prepared Statement of Tyrone Brown, Esq.

1. Summary of Position

Mr. Chairman, Members of the Committee:

My name is Tyrone Brown. I am an attorney who has been engaged in telecommunications practice for much of the past 25 years. I am appearing before the Committee in two capacities.

First, I testify as one who was a Commissioner at the Federal Communications Commission in 1978 when the agency unanimously adopted the minority ownership tax certificate policy. That policy provided for issuance of a tax certificate under section 1071 of the Internal Revenue Code, permitting deferral of taxation of profits received by the seller, upon the sale of a radio or television broadcast station to a minority individual or firm. In 1982, the FCC extended this policy to sales of cable television systems to minorities.

Mr. Chairman, I do not purport to be a tax expert. But as a former official involved in the process, I do wish to persuade the Committee that the FCC's 1978 and 1982 initiatives were good and needful policies when they were adopted, and they remain so today. By this I mean that the minority ownership initiatives were necessary to overcome a glaring marketplace defect; they have been modestly effective in achieving that result; they have done so without the use of quotas or exclusive set-asides or mandated requirements; and they are broadly beneficial for all of us—for all Americans—and not only for the sellers and buyers involved in particular transactions.

The second capacity in which I appear before this Committee, Mr. Chairman, is as an attorney whose law firm, Wiley, Rein & Fielding, represents various parties, with varying interests, who strongly oppose repeal of section 1071. They include Viacom and other cable television clients, although I do not appear on their behalf today.

Our clients also include a number of firms which are vitally interested in the telecommunications spectrum auctions now being conducted by the FCC. Those auctions will result in the sale of newly-allocated radio telecommunications channels to successful bidders who will use them to provide a new generation of enhanced cellular and cordless telephone services to the American people. It is estimated that this newly created sector, called the Personal Communications Service or PCS, eventually will add $50 billion annually to our economy. That is why hopeful bidders have already committed more than $6 billion, to be paid to the Government this year, just for the right to operate on the PCS channels. And, the current auctions involve only half of the total spectrum reserved for the Personal Communications Service.

Mr. Chairman, as I shall show, the FCC's rules for rapid deployment of PCS are directly implicated, in three distinctly different ways, by the proposed repeal of sec-

tion 1071. First, the rules rely on the availability of the tax certificate to induce current users of the PCS channels to vacate them so that winning PCS bidders may quickly deploy their systems. Secondly, the Personal Communications Service rules also rely on the tax certificate to encourage start-up investment in firms controlled by minorities or by women. Finally, as expressly mandated by Congress in 1993 legislation authorizing spectrum auctions, the PCS rules contain a number of outright bidding preferences for small businesses, for rural telephone companies, and for "minority groups and women."

PCS bidders and others are becoming increasingly concerned that ill-considered and global rejection of the FCC's tax certificate authority under section 1071 could have the effect of delaying deployment of the first PCS systems. Without the inducement of tax certificates, the allocated channels may not be vacated on a timely basis by their current users. Worse still, the rejection of minority ownership incentives as reflected by the proposal to repeal section 1071 provides aid and comfort to those who would use the courts to prevent timely FCC auctions for the second half of the PCS channels, or who would throw the entire Personal Communications Service regulatory scheme into time-consuming litigation.

For these reasons, I would urge the Committee to move very cautiously and judiciously in this area. The very real possibility exists that we could reap uncertain and relatively insignificant benefits from repeal of section 1071, and at the same time jeopardize the certain and very significant benefits that would surely flow from timely development of the PCS sector. These benefits are to be measured in terms of both thousands of new jobs and billions of dollars in new spectrum-use fees as well as new tax revenues.

My conclusion, Mr. Chairman, is that at this juncture Congress will generate the most new revenue quickly by reaffirming the viability of the minority and female preferences set forth in the 1993 amendments relating to spectrum auctions, including specifically the ways in which the FCC is using the tax certificate to carry out the congressional mandate. This in turn involves a reaffirmation, and not a repeal, of section 1071.

2. The FCC's Tax Certificate Policy Is Effective; It Should Not Be Eliminated.

I recognize, Mr. Chairman, that my claim about the potential impact of repeal of section 1071 upon the timely development of the Personal Communications Service is a large one, and I shall devote some time in my testimony to explaining it.

To place the PCS connection in chronological perspective, however, I need first to explain why I and six other FCC Commissioners concluded unanimously in 1978 that something had to be done to spur minority ownership in the broadcast industry, as a similarly unanimous FCC concluded with respect to the cable industry in 1982. I must also explain why we turned to section 1071 as a preferred instrument in working toward this goal, and why the tax certificate authority is still the best means for gradually overcoming the dearth of minority ownership in the electronic media.

I want to describe fairly and quickly the situation that I confronted when I arrived at the FCC in 1977. I believed, as I still do, that television (including cable) and radio are the most insistently intrusive and the most intrusively insistent, the most entertaining and information-laden and ubiquitous mass communications vehicles yet conceived by humankind. As a nation, for better or worse, we literally commune over radio and television.

Back in 1978, to attempt to convey to one of my fellow Commissioners what this sometimes meant to minority Americans, I asked him to imagine, if he could, a national radio and television environment in which 95% of the ownership of this powerful and persuasive medium—that is, 95% of the control over ultimate decision-making authority, 95% of the ultimate control over creative expression, 95% of the ultimate control over news and information content, and 95% of the ultimate control over exploitation of the medium for profit—rested, securely, in the hands of people who look like me. This, of course, is the reverse image of the situation that did exist at the end of 1977. While minority Americans then represented approximately 20% of our population, minorities owned not much more than one-half of one percent of the nation's radio and television stations.

Mr. Chairman, I submit that fair-minded people who contemplate the image that I invoked for my colleague in 1978 will understand why many minority Americans become impatient when their desire for some improvement in this ownership situation is mischaracterized as an obsession with mandatory quotas, set-asides or preferences. We simply feel that since the electronic media, licensed by Government, have such a great impact on our lives, and on the lives of our children, and since they are the prisms through which we see and hear, and are seen and heard, some

appreciable part of the ownership interests should be in the hands of minority individuals and firms.

So the FCC Commissioners, all of us, decided in 1978 that something needed to be done. And, yes, Frank Washington, a young professional on the staff of then-Chairman Charles Ferris, was the first to raise the concept of issuing section 1071 tax certificates to broadcasters who voluntarily transferred a radio or television station to a minority-controlled purchaser.

After much deliberation, we adopted that approach. We did so because it was consistent with recent prior uses of the tax certificate authority, because it was precisely tailored for addressing defects in the marketplace that accounted for the lack of minority ownership and, finally, because the Treasury Department agreed with the FCC that this use of the tax certificate authority was permissible and appropriate. Mr. Chairman, somewhere in the bowels of the FCC or the Treasury Department there now rests the original of a document dated in 1978 which records Treasury's formal review and approval of the FCC's policy initiative in this area.

I have stated that the tax certificate precisely addresses marketplace defects that the FCC identified in 1978. About the failings of the marketplace, I can provide formal as well as anecdotal evidence. In 1977, under the leadership of Richard Wiley who chaired the FCC during the Nixon and Ford Administrations, the agency had sponsored a minority ownership conference. The conferees concluded that two principal barriers to minority ownership were, first, the minority entrepreneur's lack of access to information and, secondly, his or her lack of access to capital. The same conclusions were reached by an Advisory Committee headed by Commissioner Henry Rivera in 1982 under President Reagan's Chairman, Mark Fowler.

Mr. Chairman, the conclusions which these panels reached certainly were borne out by my own experiences. Prior to going to the FCC, I had been for a period the in-house lawyer at Post-Newsweek stations, the broadcast subsidiary of the Washington Post. During my time there, the Company acquired a television station. Discussions leading to that acquisition, including even the fact that the station was on the market, were kept a total secret. Three courtly gentlemen representing, respectively, the seller, the buyer and the broker were the only persons who had the relevant information. I am not criticizing the Washington Post. They are the people who gave an FM station—now WHUR—to Howard University. I merely wish to emphasize that total secrecy about the availability of broadcast properties was standard operating procedure then. When information is a surrogate for money, those who have it naturally hold it close.

The availability of the tax certificate changed this situation to a degree. It gave owners an incentive to seek out prospective minority purchasers. It gave the minority entrepreneur a chip at the bargaining table, and it opened doors at financial institutions that formerly were closed. This was all that the FCC attempted to accomplish when we established the program in 1978. Its beauty lay in the fact that we did not rely on quotas or set-asides or mandatory requirements. We simply provided a tax incentive for the seller to take into account among all the other factors that go into determining whether or not to sell, when to sell, and to whom.

We believed, Mr. Chairman, that the tax certificate policy would have a modest impact on ownership patterns. The record demonstrates that this is all that has occurred. Since 1978, while there have been approximately 16,000 sales of radio and television properties, sales to minorities under the tax certificate program have amounted to only 325 or so transactions, less than 2% of the total. For cable television, the proportion of minority ownership tax certificate transactions is even smaller.

We also believed in 1978 that there was nothing extraordinary about the fact that issuance of a tax certificate would permit the seller to defer payment of taxes on the profits from a sale of a communications property to a minority individual or firm. Tax deferrals, under provisions other than section 1071, were and are far from unique in our tax laws. They are in fact quite common.

For example, Mr. Chairman, we could put to one side the proposed Viacom transaction. Still there would remain at least five other major cable system transactions—ranging in size from $1.4 billion to $2.6 billion—that have either been announced or completed within the past year. These transactions are described in Appendix I to this Statement. None of them involves issuance of a minority ownership tax certificate, but all of them were structured to achieve tax deferral under some other provision of the Internal Revenue Code.

Finally, Mr. Chairman, we believed in 1978 that use of the tax certificate to encourage minority ownership was fully consistent with prior uses of section 1071. This provision had always been used by the FCC to decrease concentration of control, to increase competition and to encourage innovation and diversity.

Thus, the FCC issued its first tax certificate under the predecessor of 1071 more than 50 years ago, to permit nonrecognition of profits that NBC received when it was prevailed upon to sell one of the two radio networks that it then owned. The divested network became ABC. Later, the FCC used the section 1071 authority to encourage the break-up of newspaper/television and television/radio combines in the same community, and to require the break-up of telephone company/cable system combines in the same service area.

Given the virtual lockout of minorities from ownership of broadcast and cable outlets in 1978, the FCC's decision to use section 1071 to stimulate some increase in minority ownership was wholly consistent with these prior uses of the tax certificate authority. And, clearly, the need for this program continues today. Because of the FCC's policy, minority ownership has increased to approximately 3%. I believe that, due to growing pressures to consolidate within this industry, elimination of the minority ownership tax certificate program would result in a diminishment in even this modest level of ownership participation by minority individuals and firms. This is why I strongly oppose elimination of the program.

3. Repeal of Section 1071 May Result in Significant Delay to Licensing and Deployment of PCS Services.

Mr. Chairman, the FCC's announced intention to employ tax certificates to get the new Personal Communications Service off the ground is also a very important reason why Congress should not repeal section 1071. Here, too, the agency plans to use the tax certificate to spur innovation and competition as well as diversity in ownership. In the case of the Personal Communications Service, Congress has unmistakably mandated both rapid deployment of the new technology and diversity in ownership participation.

The new, enhanced cellular telephone and cordless telephone service is being developed under a provision which Congress added to the Communications Act in 1993. This provision directs the FCC to allocate certain radio communications channels through a process of competitive bidding. As I have indicated, the FCC-supervised auction of PCS channels is now in progress, and hopeful bidders already have committed to pay more than $6 billion in spectrum-use fees into the U.S. Treasury.

These companies are bidding for the right to develop and deploy an enhanced cellular telephone service that will, for the first time, provide direct competition to the existing local exchange telephone system. The new service will reach perhaps 30% of the U.S. population within ten years and it will generate $50 billion annually in revenues by the end of that period. However, Mr. Chairman, this new service cannot be launched while the radio channels allocated to it are occupied by other users. It is to deal with this problem that the FCC has announced one of its planned uses of the tax certificate authority in deploying PCS.

Mr. Chairman, Appendix II attached to this Statement describes this problem in detail and the FCC's planned use of the tax certificate to help solve it. To summarize, it turns out that the radio channels that are best suited for the new PCS services are currently being used by large utilities, by pipeline companies, by railroads and the like for internal communications purposes. The FCC has told these "incumbent users" that they will have to move their internal communications links to other operating frequencies. At the same time, the FCC has stipulated that PCS service providers—the successful bidders in the current and future auction rounds—will be required to pay for new communications equipment which the incumbent users will need to install when they migrate to different operating frequencies.

The FCC has established a three-year period for negotiations between the PCS service providers and the affected incumbent users to obtain the latter's voluntary agreement to relocate out of the PCS band of radio frequencies. After the three-year voluntary period, mandatory proceedings may be brought to force "relocation" on equitable terms. To provide an incentive for incumbent users to migrate to their new operating frequencies as quickly as possible, the FCC has stated that it will grant tax certificates to those incumbent users who move out of the PCS frequency band within the three-year voluntary negotiation period.

The availability of a tax certificate in these situations may provide a significant incentive. While the Internal Revenue Service probably would not treat the replacement of the incumbent user's existing equipment by the PCS provider as a taxable transaction, this is not a certainty. And, differing fact patterns might result in differing tax treatment. Issuance of the tax certificate will resolve these uncertainties. Moreover, since the tax certificate will be available only during the three-year voluntary negotiation period, there is a built-in incentive for incumbent users to vacate the PCS radio frequencies early in the process.

This, Mr. Chairman, is one example of how the FCC has made judicious use of the tax certificate to encourage the rapid deployment of a new technology. Some

years ago, the agency similarly used the tax certificate to encourage needed consolidation of ownership in cellular telephone firms that were chronically fragmented in their ownership structures. If section 1071 is repealed, the agency will lose its ability to respond in timely fashion to problems such as these.

With respect to PCS, I believe that unless the tax uncertainties are resolved and incentives are provided to encourage voluntary migration out of the PCS bands by incumbent users, it will be many years before the new Personal Communications Service can be fully deployed. Clearly, much more would be lost in tax revenues that way (and in possible spectrum fees as well) than would be gained by repeal of section 1071.

Mr. Chairman, as I indicated at the outset, there are two additional ways in which repeal of section 1071 would have a direct impact upon the development and deployment of the Personal Communications Service. They both flow from the directive to the FCC, contained in the 1993 amendment of the Communications Act, to pursue the following objective:

> "Promoting economic opportunity and competition and ensuring that new and innovating technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women."

Section 309(j)(3) of the Act thus directs the FCC to pursue the goals of competition and diversity of ownership. The agency has responded to that directive by establishing an entrepreneurial set-aside, and preferences and incentives in the competitive bidding process for rural telephone companies, small businesses, minorities and women. One of the incentives that the FCC plans to provide to encourage start-up investment in minority and women controlled firms will be issuance of tax certificates to those who provide the start-up capital.

Bidding for the licenses that have been set apart for smaller firms and entrepreneurs is scheduled to begin this spring. Parties have been negotiating their financing and investment arrangements for some time. Repeal of section 1071 and, therefore, elimination of the FCC's ability to issue tax certificates in this context will have an impact on these negotiations. How severe that impact will be is not clear. But we do know of at least one major potential investor in entrepreneurial firms which has backed away since the House of Representatives voted to repeal section 1071.

Mr. Chairman, this brings me to my central concern about the hasty outright repeal of section 1071 as voted by the House. If that action prevails, Congress will be sending contradictory signals to the FCC, to the investing public, to the American people, and ultimately, to the courts.

The House repeal of section 1071 has been read generally as a repudiation of minority ownership initiatives with respect to communications properties. How is the FCC, having just established a regulatory regime to comply with section 309(j) of the Act, to respond at this point? Does it change its rules? How are the companies now bidding for PCS spectrum to gauge whether the entrepreneurial set-aside will ever actually materialize? How are they to measure the impact of withdrawal of the FCC's tax certificate authority on their business plans?

4. Conclusion.

Mr. Chairman, I believe there is a need to stop, look and listen. Does the Congress, consistent with repeal of section 1071 in the House, want to back away from section 309(j) of the Act? Are we risking delays in completion of the licensing process for PCS on the order of many, many months? I believe that we are. This is a second reason why I urge the Committee to reaffirm the objectives set forth in section 309(j) of the Act and leave intact the FCC's ability to issue tax certificates under section 1071.

Thank you, Mr. Chairman.

APPENDIX I.—EXAMPLES OF RECENT TAX-FREE CABLE TRANSACTIONS

1. Continental Cablevision's acquisition of Providence Journal cable properties was structured as a tax-free stock deal. The deal, announced in November 1994, has not been consummated. Estimated purchase price—$1,400,000,000.
2. Time Warner's acquisition of Summit Communications was structured to be a tax-free stock deal. The deal, announced in late 1994, has not been consummated. Estimated purchase price—$350,000,000.
3. TCI's acquisition of TeleCable Corp was a tax-free merger. That deal was consummated in 1995. Estimated purchase price—$1,560,000,000.

4. Cox Cable's acquisition of Times Mirror Cable was a tax-free merger. That transaction was consummated in 1995. Estimated purchase price—$2,300,000,000.
5. Time Warner announced in February 1995 it will acquire Cablevision Industries. The deal has been structured as a tax-free merger. Estimated purchase price—$2,600,000,000.
6. Time Warner announced in January 1995 it will acquire KBLCOM, Inc. from Houston Industries in a tax-free stock deal. Estimated purchase price—$2,200,000,000.
7. Time Warner's announced joint venture with Advance/Newhouse will be a tax-free endeavor. That transaction, announced in September 1994, has not been consummated.

Appendix II.—Use of FCC Tax Certificates in the PCS Context

What is PCS?

- Personal Communications Services (PCS) are a family of mobile radio communications services that provide individuals and businesses with unprecedented communications opportunities enabling people to communicate anytime and virtually anywhere.
- Examples of PCS include small, lightweight, multi-function portable phones (for both home and office), portable facsimile and other imaging devices, and new types of multi-channel cordless phones.
- In 1990, the FCC determined that the currently available forms of PCS, such as cellular and paging services, would meet neither the future technological needs nor the future volume of service demanded by American consumers and businesses. It thus began a proceeding to allocate radio frequencies, or spectrum, for the next generation of PCS systems and devices.
- New wireless customers are being added at a rate of over 45% per year, and revenues at the end of the next 10 years are expected to exceed $50 billion. Forecasts predict that within 10 years, 24% to 38% of the U.S. population (70-110 million persons) will subscribe to a wireless telephone service.

Why are Microwave Licensees Being Asked to Move?

- PCS is only feasible on frequencies below 3 GHz with current technology, but there are no large blocks of unallocated spectrum in that range. Thus, the FCC has reallocated the spectrum currently used by private fixed microwave communications systems for PCS because microwave systems can operate at higher frequencies and such allocation is consistent with that being used internationally.
- These incumbent microwave operators typically include railroads, oil pipelines and electric utilities that built their microwave systems primarily for internal communications purposes.

Why are Tax Certificates Important in the PCS Context?

- In July 1994, the FCC authorized the use of Section 1071 tax certificates to facilitate deployment of the new PCS services.
- Under this policy, the FCC will issue tax certificates to incumbent microwave operators who currently transmit in the 2 GHz band, if such operators voluntarily migrate to other frequencies, thereby clearing the 2 GHz band for PCS technologies.
- Under the FCC's rules, the incumbent microwave licensees in this band must relocate to other frequencies in any event. However, the tax certificate would provide a means for them to avoid the tax penalty associated with this mandatory relocation.
- Moreover, inasmuch as the tax certificate would be available only if the incumbent microwave operator voluntarily moved within three years, it would encourage such licensees to relocate more quickly than they otherwise would—2 to 5 years more quickly.

How will the Tax Certificates Work?

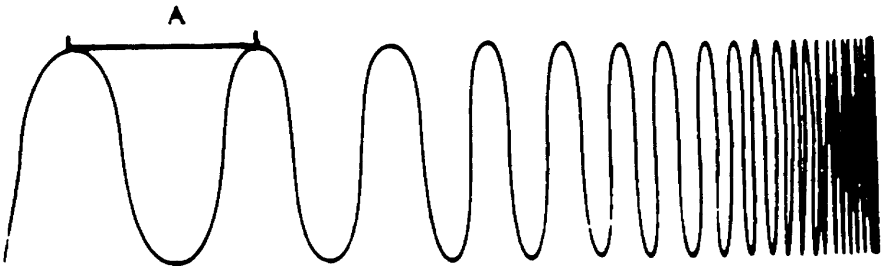
- PCS licensees (in the licensed PCS spectrum) and PCS equipment manufacturers (in the unlicensed PCS spectrum) will pay for and install new facilities to permit the incumbent microwave operators to relocate to another frequency band; the old 2 GHz equipment will become the property of the PCS manufacturers.
- The issuance of a tax certificate to the incumbent microwave licensee will ensure that this exchange does not constitute a taxable event. Thus, the incumbent licensee would not have to pay taxes on any "gain" realized from the invol-

untary exchange of their old microwave equipment for the new equipment they will need to operate at higher frequencies.

- As such, the tax certificate should encourage early, voluntary relocations and thus facilitate clearance of the 2 GHz band for use by the emerging PCS technologies.

Where is PCS Now?

- The FCC is currently in the final rounds of conducting auctions of licensed PCS spectrum.
- The bidding level now exceeds $6 billion, which will be paid directly to the U.S. Treasury.
- The applicants' bidding strategies were fashioned in reliance on the availability of these tax certificates and the incentive they would provide for swift, efficient deployment of PCS.
- It is expected that several thousand tax certificates will be required to fully deploy PCS.
- Spectrum is the range of electromagnetic waves that pervade our environment.
  - It is naturally occurring.
  - It is divided up according to frequencies.
- Frequencies are the measurements of how rapidly these electromagnetic waves are moving.



- For instance, imagine that at "A" on this chart, one electromagnetic wave occurs every second or hertz. This frequency would be referred to as the 1 Hz frequency.
- At lower frequencies, there are fewer electromagnetic waves per second. At higher frequencies, there are more.
- For delivery of telecommunications services, radio frequencies are not interchangeable because the technical characteristics of any frequency depend on that frequency's location in the spectrum. Thus, certain telecommunications technologies are better suited to some parts of the spectrum than others.
  - AM, FM and TV typically use the lower frequencies. Characteristics of these lower frequencies include:
    - ability to travel greater distances;
    - ability to handle a lower information content;
    - need for bigger antenna to receive signals; and
    - ability to penetrate buildings easily.
  - Cellular, Paging and PCS typically use the higher frequencies. Characteristics of these higher frequencies include:
    - cannot travel as far as lower frequencies;
    - can handle greater information content;
    - do not require large antenna to receive signals; and
    - cannot penetrate buildings easily.

PREPARED STATEMENT OF HON. KENT CONRAD

Mr. Chairman: Thank you for having this hearing. I must say I am rather sorry it was necessary. I am sure that the Americans affected by the expiration of the self-employed health care deduction do not understand why Congress cannot act to extend that deduction when it has such overwhelming support. We have already missed the March 1 deadline for farmers. At the rate we are going we may not be

able to act by the April 15 filing date which applies to everyone else. Hopefully today's hearing will make our next step clear. I suggest, however, that if we cannot quickly resolve the issues surrounding the proposed method of paying for the extension, that we look elsewhere for revenue. Thank you Mr. Chairman.

PREPARED STATEMENT OF W. DON CORNWELL

Chairman Packwood, Senator Moynihan, and Members of the Committee on Finance, my name is Don Cornwell. I am Chairman of the Board of Directors and Chief Executive Officer of Granite Broadcasting Corporation ("Granite"). In addition to my duties at Granite, I am also active in the broadcasting industry as a member of the television board of the National Association of Broadcasters. My company is a member of the National Association of Black Owned Broadcasters. I appreciate the opportunity to submit testimony on section 1071 of the tax code. The Federal Communications Commission ("FCC") has used this provision as a way to promote diversity of viewpoints in the media, by encouraging greater minority ownership of radio, television and other properties.

BACKGROUND ON GRANITE'S OPERATIONS

Our operations highlight the benefits of the FCC tax certificate program. Granite owns and operates seven network affiliated television stations across the country, all of which were acquired under this program. We have stations serving California, Illinois, Indiana, Minnesota, New York, Texas, and Wisconsin. We are also in the process of acquiring a station in Michigan.

We bought our first and smallest stations in 1988. These stations, which are located in Duluth, Minnesota and Peoria, Illinois, are necessarily small because only my own equity capital, combined with that of family, friends and a former employer, was used to purchase these stations. Over time, Granite has developed a strong reputation, enabling it to attract the amounts of capital required to acquire larger stations.

Over the next six years, we acquired five additional network affiliated television stations and a large interest in a sixth station. In 1989, we acquired stations in Fort Wayne, Indiana and San Jose, California. In 1993, we acquired stations serving Fresno, California and Syracuse, New York, and the largest equity stake in the leading television station serving Buffalo, New York. We recently acquired another station serving the Austin, Texas market.

By the end of 1995, Granite will consist of eight stations (plus our equity interest in the Buffalo station) competing in television markets ranging in size from Grand Rapids-Kalamazoo-Battle Creek, Michigan to Duluth, Minnesota-Superior, Wisconsin. These markets range in size from the 36th to the 128th market. We will employ approximately 750 individuals; and, after six years, we will have become the largest African-American controlled company in the television station ownership business.

Our objective is to ensure that Granite is strong enough to compete in the electronic media market in the 21st century. We will remain builders; and, thus, we have not and will not engage in the trading of stations. We continue to own each station we have acquired to date. We have done this despite receiving attractive offers to sell.

We believe that our ownership of each of these stations has made a difference. Each station, while affiliated with one of the three traditional networks, is directed to become the leading provider of local news, weather, and sports information in our communities of service. In addition, we pride ourselves on the strength of our involvement in our local communities.

ENCOURAGING PROGRAM DIVERSITY: DEVELOPMENT OF SECTION 1071

Mr. Chairman, one of the areas on which you requested testimony relates to the Federal Government's role in encouraging ownership of media properties by minorities through affirmative action programs. Frankly, I do not view the minority tax certificate program as an affirmative action program. The program emanates from congressional, regulatory, and judicial directives, based on the First Amendment, to promote diversity of views in the media. Thus, encouraging minority ownership of media properties is a means to an end, not an end in and of itself.

The minority tax certificate program is consistent with Code section 1071 because it furthers the First Amendment's and that section's goal of promoting program diversity. The predecessor to section 1071 was enacted in 1943, emanating from the adoption of FCC ownership regulations prohibiting common control of certain directly competing radio stations. These ownership rules were directed toward ensur-

ing diversity in the content of broadcasts. As a result of the new policy prohibition, a number of licensees that held interests in two stations were required to dispose of one of these interests. Lawmakers enacted the predecessor to section 1071 (old section 112(m)) to afford relief, through issuance of tax certificates, to taxpayers who were required to dispose of certain broadcast holdings. Since 1943, the FCC has expanded its multiple ownership rules to prohibit a number of cross-ownership situations. Ironically, in more recent years, the FCC has again reversed itself and liberalized the multiple ownership and cross-ownership rules in markets where sufficient diversity of viewpoints is available.

In 1978, the FCC expanded its program to promote diversity of viewpoints. Under this new program, the FCC announced it would issue tax certificates for sales of broadcast facilities to "parties with a significant minority interest" in cases where "there is a substantial likelihood that diversity of programming will be increased." Congress did not change the language in section 1071 when the FCC's new policy was put into effect. Much like its 1943 action in breaking up cross-ownership arrangements because they limited diversity of viewpoints in the marketplace, the FCC extended the tax certificate program to minorities as an acknowledgement that its prior actions in granting licenses had failed to take into account the importance of minority ownership and control of licensees in achieving the desired diversity of viewpoints in the marketplace.

DESCRIPTION OF CURRENT MINORITY TAX CERTIFICATE PROGRAM

Current section 1071 is restrictive and is helpful only in those cases where the seller is in a tax position to use the certificates. If qualified, the tax certificate program can provide effective incentives for a station owner to sell to a minority or for an investor to provide financing for the minority owner.

Under the minority tax certificate program, the FCC is allowed to issue a tax certificate only to two classes of taxpayers: (1) a seller of a broadcast station upon the sale or exchange of the broadcast property to a minority-controlled company, or (2) an initial investor who provides the necessary "start-up" financing to a minority-controlled purchaser of a broadcast station. The tax certificate enables the qualified taxpayer (i) to defer payment of capital gains tax on the sale of the broadcast property or interest, provided that the taxpayer reinvests the proceeds in qualified replacement property, or (ii) to reduce the basis of certain depreciable property remaining in the taxpayer's hands immediately after the sale of broadcast property or interest, or acquired in the same taxable year.

To qualify under the FCC's minority tax certificate policy, the minority company must demonstrate that it is minority controlled. Traditionally, the test with respect to corporate applicants has been whether minorities own more than 50% of the voting stock. More recently, the Reagan Administration expanded the eligibility requirements to permit limited partnerships with minority general partners to qualify, provided that the minority partner owns at least 20% of the partnership's total equity.

Additionally, the issuance of a tax certificate is dependent upon the timing of certain events. A seller of a broadcast property can be issued a tax certificate only after the sale or exchange has actually occurred. Initial investors in a minority-controlled purchaser of a broadcast station can be issued a tax certificate only after the sale of their interests in the minority-controlled buyer. A minority company that obtains a broadcast station involving a tax certificate must retain the station for at least one year. This restriction does not apply if a minority company proposes to sell the station to another minority company within the one-year period.

TAX CERTIFICATE PROGRAM'S SIGNIFICANT IMPACT ON DEVELOPMENT AND GROWTH OF COMPANY

Although we recognize that a number of factors have helped our business succeed, the minority tax certificate program has been extremely important in the development and growth of our enterprise. The program has allowed Granite to acquire each of its existing stations, so that now we are large enough to offer minorities real employment and business opportunities.

Valuation and certainty of financing ultimately determine the willingness of a seller to accept any of our acquisition proposals; however, Granite's experience indicates that the tax certificate program clearly has been helpful in persuading owners to consider and accept our proposals. For example, we were able to persuade companies such as Pulitzer, Landmark Communications, and Meredith to sell us television stations which they originally had not intended to sell at all. Thus, the tax certificates have increased our access to station owners who were not actively looking to sell their properties. The certificates have also facilitated our ability to raise capital

(both debt and equity) by allowing us to negotiate favorable terms for most of our stations.

However, there is no guarantee that the tax certificate will make our proposal the most attractive to a particular seller. In some cases, the seller does not expect to realize any significant taxable gain. In other cases, the seller is going out of business and has no interest in reinvesting the proceeds of the sale in "like kind" property acceptable to the IRS in order to realize the tax certificate's benefits.

TAX CERTIFICATE PROGRAM EFFECTIVELY USES MARKET INCENTIVES TO ENHANCE PROGRAM DIVERSITY

The Federal Government has recognized that minority ownership of broadcast media helps achieve the goal of promoting program diversity. The minority tax certificate program uses economic incentives to encourage station owners to sell to minority purchasers and investors to provide start-up capital to minority broadcast companies. Using market-based, economic incentives is an efficient means to promote program diversity. Minority ownership has increased almost sixfold, from 0.5 percent to 2.9 percent of all broadcast licenses in a growing market. Thus, by using the carrot rather than the stick, the FCC has made major strides in correcting the historically low level of minority ownership and, thereby, has promoted its ultimate goal of enhanced program diversity.

Other alternatives are less desirable. For example, direct grant programs or mandating programming by the licensee requires the Federal Government to decide how best to allocate resources or determine program content, while public access requirements unfairly restrict an owner's ability to exercise editorial discretion in the operation of a station.

On a related point, much of the recent debate in the House of Representatives focused on how the tax benefit under the minority tax certificate program goes to the seller of the property, who is often a non-minority owner, and not to the minority purchaser. Frankly, I do not see the difference between the minority tax certificate policy and many other incentive-based provisions of the tax code. For instance, I am sure that the tax incentives offered to entrepreneurs who invest in Enterprise Zone businesses often inure to those who are not economically disadvantaged. In that case, Congress did not focus on whether the recipient of the economic benefit was already rich or poor—in fact the investor in an Enterprise Zone is likely to be similar to the seller of the broadcast station. This result should not matter in either case, if the ultimate goal of the program is advanced.

My own experience tells me that the minority tax certificate program accomplishes the FCC's goal of encouraging program diversity. Granite is proud of its stations' aggressive promotion of diverse news and programming in their markets. For example, after Granite acquired a west coast television station in 1993, the station's general manager immediately formed two advisory boards, an Hispanic Advisory Board and a Community Advisory Board, so that the station could better serve the entire community. These boards meet quarterly with station management. As a result of these meetings, the station honored five Hispanic community leaders in its newscasts and with on-air vignettes throughout last September's celebration of Hispanic Heritage Month. Similarly, last month, the station honored five African-American community leaders to celebrate African-American History Month. It is important to note that this station is the only television or radio station in its market which is making such an aggressive effort to reach out to the minority community. This is just one example of how minority ownership advances the government's goal of providing diverse programming. While I am careful not to inject myself into my station managers' programming decisions, the aforementioned example illustrates that a station's editorial policies in general reflect its ownership's views. The Supreme Court believes so as well.

POTENTIAL ABUSES OF PROGRAM RAISES CONCERN

Granite shares the concerns of the Congress and the FCC about potential abuses of the minority tax certificate program. In that regard, we were extremely careful in the creation of Granite to satisfy what we perceived as not only the letter, but also the spirit, of the FCC's policy.

When my partner and I founded Granite in 1988, the investment I made represented then and today virtually all of my family's net worth. My investment bought the majority of the voting stock in Granite, and no one has the right to purchase my equity position or exercise any of my rights as the control shareholder. Specifically, pursuant to Granite's Articles of Incorporation, the only voting stock of the Company is Class A Voting Stock, of which I own 55 percent. As such, I have the absolute and sole right to elect and remove all members of the board of directors

of Granite, to control the direction and management of Granite and to approve the sale or merger of Granite. Granite's nonvoting common and preferred stocks are publicly traded, and have no voting rights whatsoever, except as required by Delaware law. Granite's Articles of Incorporation can be amended or modified only by a vote of the holders of a majority of Class A Voting Stock (i.e. myself). Further, not only do I operate as the Chairman and CEO of the Company, we also have significant minority representation on our Board of Directors.

When we have acquired stations, in many instances the seller has spent a considerable amount of time conducting its own due diligence regarding the structure of Granite. I specifically recall the transaction where Granite acquired our Fort Wayne, Indiana station, WPTA-TV, where the seller's counsel insisted that Granite prove its strict compliance with the law. Such due diligence should be a requirement in every transaction.

Granite has set an additional standard for itself when it participates in this program. While this standard would be inappropriate as an act of legislation, we would like to go on record as to our practice. We believe that the benefits realized by our Company from the tax certificate policy require us to exceed expectations, that otherwise might exist from the average company in our industry, with regard to helping increase minority representation and thus promoting diversity of viewpoints in the broadcast medium. We are not a rich company, despite our rapid growth. However, we have stretched financially to create paid station employment opportunities as a means of providing young people—mostly minorities—an opportunity to gain entry level employment. In addition, we have contributed significantly to industry-supported foundations which are designed to encourage minority students to enter the broadcasting field. We also make available our stations and management to assist in training minorities who participate in a Commerce Department program for prospective owners of new stations.

Mr. Chairman, we agree that reform is necessary, and we welcome the opportunity to work with your Committee and the Administration to develop ways to ensure that the spirit of this program is satisfied. We believe that satisfaction of that spirit requires a significant at-risk investment by minority investors at the inception of the enterprise, executive management control, and the absence of mandatory rights by non-minority investors to buy out the controlling minority investor. Further, we believe that the Congress and the FCC should require a written representation and warranty from the recipient of the tax certificate that these or other appropriate standards have been met to the best of their knowledge.

RETROACTIVITY OF EFFECTIVE DATE

There has been extensive discussion regarding the retroactive effective date of H.R. 831, as passed by the House of Representatives. I would like to focus on two specific aspects of the effective date. First, the bill does not address the treatment of investor certificates. As discussed above, investor certificates are issued to persons who provide start-up capital to minorities. The Federal Government established these certificates to induce the investor to provide capital at the time the station is acquired. However, the certificate is not issued until the investor sells his or her interest, provided that the station is still minority-controlled. Under H.R. 831, the investor cannot receive the benefit of this bargain with the Federal Government, although the investor has already completed all of the requirements imposed under this program.

Second, the transition rule in H.R. 831 does not fairly meet its intent to cover those parties which were put on notice that the law would change and that transactions could not thereafter be negotiated to avoid the change in law. Rather than rely exclusively upon a binding contract rule, the transition rule should also include another objective test. This rule would cover situations in which an application for voluntary assignment or transfer of control has been filed. This is a simple test which can be verified by looking at the FCC's public record. Accordingly, if applications for a license transfer and for a tax certificate had been filed with the FCC prior to the date of Chairman Archer's announcement, no one could argue that the parties changed their behavior in contemplation of the change in the law.

ANOTHER SUGGESTION TO IMPROVE SECTION 1071

As long as you are examining section 1071, we would like to offer a suggestion to improve the tax administration of this provision and make capital more available to minorities. An important requirement of the provision is that the holder of a certificate must reinvest the proceeds in "property similar or related in service or use to the property converted." For this purpose, "stock of a corporation operating a . . . broadcast station, whether or not representing control of such corporation," is

considered property eligible for reinvestment and tax deferral. In Rev. Rul. 66-33, 1966-1 C.B. 183, the Internal Revenue Service interpreted section 1071 to require that stock in a corporation which holds its licenses and conducts operations through wholly-owned subsidiaries rather than directly, is not "property similar or related in service or use," even when the sole assets of the parent are stock in subsidiaries which hold licenses and operate broadcast stations.

This interpretation is too restrictive. At present, Granite holds one of its licenses directly; the others are owned in subsidiaries. Our lenders are constantly demanding that we hold all of our licenses in separate subsidiaries in order to protect their interests as creditors. Since the Supreme Court has held that the lender cannot acquire a security interest in the license itself, lenders can best protect their interests if they obtain a pledge of the stock of the subsidiary holding the license, along with negative pledges. It is important that a company like Granite be considered property similar or related in service or use in order to attract additional capital from sellers seeking to reinvest. Yet, lending restrictions make that difficult to maintain and, in many cases, impossible.

No harm would be done to the intent of section 1071 if Rev. Rul. 66-33 were overruled by amending the statute explicitly to permit stock in a corporation primarily engaged in operating radio broadcast stations, directly or through subsidiaries, to be investments eligible for deferral of gain. We would welcome discussions with you or your staff to determine if a resolution of this problem is possible.

CONCLUSION

Granite's experience with the minority tax certificate program shows that the program serves the intended goals of encouraging minority ownership in the broadcast industry and thus promoting diversity of content in broadcasts. The program has been very important to the growth and development of our Company, and has also encouraged the reinvestment of capital in our economy.

Granite shares Congress' and the Administration's concerns about potential program abuses. The Company has taken great pains to comply with both the letter and spirit of the program. We welcome this opportunity to work with the Congress and the Administration to develop ways to ensure that the program continues to serve its intended purposes, both from a communications policy and tax policy perspective.

Thank you for allowing me an opportunity to testify. I would be pleased to answer any questions.

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[1] See, e.g., Policy Statement on Comparative Broadcast Hearings, 1 F.C.C.2d 393, 394, n. 4 (1965), which states that "the first amendment to the Constitution of the United States 'rests on the assumption that the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public'" (quoting Associated Press v. United States, 326 U.S. 1, 20 (1945) (cited in Metro Broadcasting v. F.C.C., 497 U.S. 547, 567 (1990))). The Court in Metro Broadcasting also noted the FCC's obligation under the Communications Act of 1934 to promote diversity of programming. See Metro Broadcasting, 497 U.S. at 554-55 (citations omitted); see also, Statement of Policy on Minority Ownership of Broadcasting Facilities, 68 FCC2d 979, 980 (1978) ("[D]iversified programming ... is a key objective not only of the Communications Act of 1934 but also of the First Amendment.") ["1978 Policy Statement"].

[2] Former section 112(m) was enacted as part of the Revenue Act of 1943, Pub. L. No. 78-235, § 123, 58 Stat. 21 (1944).

[3] See S. Rep. No. 627, 78th Cong., 1st Sess. 53-54 (1943), reprinted in J. Seidman, Legislative History of Federal Income and Excess Profits Tax Laws, 1953-1939, at 1602-03 (1954); 1978 Policy Statement, 68 FCC2d at 983 n. 19 (tax certificates originally used to remove hardship of involuntary transfer resulting from divestiture imposed by FCC's multiple ownership rules); 47 C.F.R. § 3.35, 8 F.R. 16065 (1943). Before that time, some radio station licensees owned more than one station in the same city. See G.C.M. 37430 (1978).

[4] See, e.g., In re Radio Corp of America, 10 F.C.C. Reports 212, 213 (1943).

[5] See F.C.C. 56-919, 21 Fed. Reg. 7831 (1956).

[6] See Blake & McKenna, Section 1071: Deferral of Tax on FCC Sanctioned Dispositions of Communications Properties, 36 Tax Law Review 101, 104-06 (1980) (citing examples such as elimination of cross-ownership of AM radio stations, FM radio stations, and television stations in same market).

[7] See 1978 Policy Statement, 68 FCC2d at 982-93.

[8] For an initial investor to qualify for a tax certificate, the investment must meet the following criteria: (1) the investor must have provided "start-up capital" to the minority enterprise, defined as funds provided within one year of the company's acquisition of a broadcast property; (2) the investor must have sold its interest in the company; and (3) the company must qualify as a minority-controlled company both before the investor purchases the interest and after the investor sells the interest in the company.

[9] Qualified replacement property must be "similar or related in service or use" to the converted property. Thus, such property may consist of hard assets (e.g., broadcast or cable assets) or stock in a corporation whose income is primarily derived from broadcasting or cable operations.

[10] Gain may still be recognized under other Code sections (e.g., depreciation recapture under sections 1045 or 1050. See Glazer & Fisher, Section 1071: FCC-Certified Transactions Involving Minority-Controlled Entities, 47 Tax Lawyer 91, 110-11 (1994)).

[11] For the purpose of the FCC's tax certificate policy, the term "minority" includes Blacks, Hispanics, American Indians, Alaskan Natives, Asians, and Pacific Islanders. Minority Ownership in Broadcasting, 92 FCC2d 849, 849 n. 1 (1982) ["1982 Policy Statement"].

[12] 1978 Policy Statement, 68 FCC2d at 983 n.20.

[13] 1982 Policy Statement, 92 FCC2d at 853-55.

[14] 1982 Policy Statement, 92 FCC2d at 858.

[15] See Metro Broadcasting, 497 U.S. at 579 ("Congress and the FCC have concluded that minority ownership programs are critical means of promoting broadcast diversity.").

[16] I was quite surprised at the Joint Committee on Taxation's revenue estimate for repeal of section 1071. Granite deliberately targets station owners who would not sell without section 1071's tax deferral benefit. Were it not for our use of tax certificates, four out of our seven stations would not have been sold. Further, the revenue estimate of $1.4 billion assumes at least $4 billion of taxable gain from transactions over the estimating period. This seems high given the fact that the FCC's calculations indicate that radio and television transactions have totalled approximately $2 billion in gross purchase price over the seventeen-year history of the minority tax certificate program.

[17] See, e.g., Metro Broadcasting, 497 U.S. at 570-71 (citing TV 9, Inc. v FCC, 495 F2d 929, 938 (D.C. Cir. 1973), cert. denied, 419 U.S. 986 (1974)).

[18] Under Delaware law, such rights are limited to the right to approve any amendment to the Company's Articles of Incorporation that would change the non-voting stock in a manner that adversely affects such nonvoting stockholders' economic rights as stockholders.

[19] The House of Representatives considered an amendment to H.R. 831, proposed by Representatives Sam Gibbons (D-FL) and Jim McDermott (D-WA), which included these reforms. We support the amendment, except that the equity ownership requirement under the definition of "eligible corporations," when applied to publicly traded corporations, defeats the goal of making capital available to minorities who wish to acquire media properties.

PREPARED STATEMENT OF PHILIPPE P. DAUMAN *

Mr. Chairman and Members of the Committee, I am Philippe Dauman, the Executive Vice President, General Counsel, Chief Administrative Officer, and a Director of Viacom. I welcome the opportunity to testify today in opposition to the retroactive effective date in section 2 of H.R. 831 a retroactive provision aimed with laser-like precision at targeting and killing the legal, above-board, and widely-reported sale of Viacom's cable systems to RCS Pacific. This transaction was framed after months of negotiations, relying on long-standing national policy designed to foster minority ownership in our industry.

Mr. Chairman, I wish to stress this point. We acted in full reliance on the rules created by the Federal Communications Commission and ratified by Congress. The transaction was approved by the Viacom Board of Directors and essentially completed before the first public expression of concerns from any part of Congress on January 17. No legislation to change the program had been introduced when the legal documents were executed on January 20 or when the tax certificate application was filed on February 3. Finally, as I will demonstrate later, there are no revenues to be gained from Viacom by retroactively changing the law. The half-billion dollar Viacom tax dodge is a myth.

Mr. Chairman, it is not my intention to delve into the details or the merits of the section 1071 tax certificate program, which has been amply discussed by the other witnesses. I will note, however, that section 1071 was enacted into law in 1943. It was expanded by the FCC to include the sale of broadcast stations to minority-controlled companies in 1978, and further expanded to cover sales of cable systems and to minority-controlled partnerships in 1982 during the Reagan Administration. Moreover, to underscore its support of the program, Congress has annually for eight years legislated to prohibit the FCC from limiting the scope of the tax certificate program. It did so in 1987. It did it again in 1988. In 1989. In 1990. It did this in every subsequent year right through to the most recent action on August 8, 1994.

Against this backdrop, I would like to briefly discuss our transaction with RCS Pacific and its principals, Mr. Frank Washington and InterMedia Partners. Viacom commenced negotiations with Mr. Washington and InterMedia in June of 1994. I would stress that Mr. Washington and InterMedia, who had previously acquired and were continuing to operate cable systems in partnership, approached us together. Unfortunately, some have suggested that two major corporations first concocted a 1071 sale and then recruited a minority individual to serve as a tax certificate-qualifying front. This is simply not true. I was there.

Parenthetically, I would also note that Viacom has not been a party to any of the 330 tax certificate transactions approved by the FCC since 1978.

We proceeded to enter into what became a complex and lengthy set of negotiations. The negotiations, all drafts of the agreement, and the final agreement, were premised and conditioned on the sale qualifying under the section 1071 program. As shown in the attached chronology of this sale, the first draft of an Asset Purchase Agreement was circulated among the parties on July 24th, the Viacom Board of Directors initially approved the transaction on August 18th, ten days after Congress again barred changes to the policy, and initial financing commitments were obtained by the purchasers in mid-September.

On October 1st, we announced stay bonuses for 151 employees in Viacom Cable in an attempt to retain employees unsettled by the sale discussions. I might add that the additional uncertainty created by passage of the House bill has been followed by the loss of several members of Viacom Cable's senior management and is making it increasingly difficult to manage our cable operations.

In late October, when the seventh draft of the Asset Purchase Agreement had been circulated, the Federal Trade Commission initiated an investigation into the competitiveness of cable clustering in connection with the proposed acquisition of Tele-Cable by TCI. Although we were not a party to that transaction, we were concerned that government rejection of it would inevitably lead to a veto of our sale. As a result, we put our discussions on hold. By mid-December, the FTC approved the Tele-Cable acquisition and efforts to conclude the Viacom Cable sale were reinvigorated.

On December 14th, the Viacom Board approved the revised terms of the sale to RCS Pacific. By January 14th, all principal terms of the sale agreement were agreed to and six days later, on January 20th, the final Asset Purchase Agreement and related documents were signed by all the parties.

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* Appendix material attached to this statement was made a part of the official files of the Committee.

As of January 14th, 1995, Viacom and the purchasers had incurred in excess of $15 million in costs on this transaction—$15 million of actual out-of-pocket expenditures. This does not include the thousands of hours of employee time spent putting this transaction together or incalculable lost opportunity and human resource costs involved. Should the Committee be interested, we will be happy to document these expenditures incurred in reliance on existing law.

It is worth noting that, as often happens in our industry, the sale of Viacom Cable was extensively discussed in both the trade press and the national media. On August 15th, 1994, a detailed article discussing the proposed sale appeared in the trade journal Multichannel News, and a similar article appeared the following day in The Wall Street Journal. Both of these articles discussed the negotiations, noted that the sale would be a tax certificate transaction, and identified Mr. Washington and InterMedia, through a new entity to be called RCS Pacific, as the purchasers. Additional articles discussing the impending sale appeared throughout the remainder of 1994. In the last week in December, when many believed the agreement would be signed the following week, a new round of articles appeared which stated that Viacom had agreed to sell its cable systems to RCS Pacific. The news outlets carrying this story included The Wall Street Journal, The San Francisco Chronicle, and The Houston Post. A similar story appeared in The Washington Post on January 4th, 1995. A sample of these numerous press reports is included as an appendix to my remarks.

At no point during this entire period did any government official, whether in the executive or legislative branch, either on or off the record, express any concern about the transaction. Although large, the transaction was and is structured the same as many preceding 1071 transfers approved by the FCC. There was no reason for anyone at Viacom to believe that this transaction was in any way controversial, much less that it would come under serious attack by the House of Representatives.

In short, Viacom and the purchasers spent seven months and millions of dollars putting this sale together in reliance on long-standing federal policy. The existence of the negotiations and the agreement were widely discussed in the media through most of this period. We were acting in total consonance with the law and espoused federal policy. Our entire corporate strategy was reformatted to accommodate this particular transaction. We refuse to accept the notion that somehow we should feel guilty or ashamed for doing what Congress and several Administrations encouraged. To adopt a retroactive provision specifically aimed at killing this transaction is, we submit, a major inequity against our company and its shareholders and would expose transactions of all kinds to the fear that some future Congress would adopt targeted, retroactive legislation. We believe that no matter how large or small a taxpayer is, respect for the tax system can only be gained if the rules are consistently and fairly applied.

As I close, Mr. Chairman, I would like to spend a couple of minutes addressing some misconceptions that have arisen regarding this sale.

First, it has been publicly stated that the revenue estimate on this matter assumes the government will gain $500 million from retroactive repeal of section 1071. This is simply not true. There are no capital gains revenues to be generated from this transaction by retroactive repeal of section 1071 because this sale will not occur. Conversely, the maintenance of section 1071 will not cost the Treasury a dime in connection with this transaction. If Viacom had to pay capital gains taxes on this sale, or any other sale we might negotiate in the future given the existing market value of cable systems, our net proceeds would be less than the net present value of our current yield from the existing cash flow value of the cable systems. Simply put, a taxable sale would result in a financial loss for Viacom. Accordingly, it would be economically detrimental to Viacom and its stockholders to proceed with a taxable sale and, therefore, we will not. The retroactive repeal of section 1071 will hurt Viacom and RCS Pacific, it will obviously change the policy underlying section 1071, but it will not help the federal treasury.

Parenthetically, we are not aware of any large cable transaction in recent years which contained a significant taxable component. Tax policy today permits taxpayers to construct tax-free transactions, such as stock swaps, without chilling tax consequences. For example, Time Warner has announced almost $5 billion of nontaxable cable acquisitions in the six weeks since our sale agreement was signed. Similarly, should Viacom decide to sell its systems following a retroactive repeal of section 1071, which is by no means clear, I can assure the Committee that we will use one of the several other legal means for structuring tax-free sales and there will be no capital gains revenue.

Second, those who have suggested that Viacom must proceed with this sale because it is over-leveraged as a result of the Paramount and Blockbuster mergers are simply wrong. Viacom has ample cash flow to service our existing debt load—a fact

we would be happy to substantiate. In any event, because a taxable sale to the buyers would fall to equal the value of existing cash flow, such a sale would have the effect of increasing our debt burden. Viacom's decision to move away from cable subscription to a programming and content orientation is to us as a business matter strategically important, something we have openly discussed. But it is not necessary or even desirable at any price.

Third, we reject the view that the House-passed bill is not a retroactive change because Viacom was somehow on notice as of a January 17th unilateral Ways and Means Committee press release indicating that the law might be changed. The fact is, as I have stated, that the sale was for all intents and purposes completed, except for final legal documentation, before January 17th. In fact, the press release itself was a response to media reports that the Viacom Cable sale was about to be consummated. Subsequent to the press release, no legislation was introduced to change or repeal section 1071 until the evening of February 6th, the eve of the Ways and Means mark-up and well after our documents were signed. Moreover, as passed by the House, over a month after our agreement was signed, the effective date contains language that violates long-standing principles of contract law, by redefining our agreement to be a non-binding contract. Finally, we note that a Member of the Ways and Means Committee stated during markup that the effective date was chosen to get the Viacom Cable sale.

Fourth, there have been private suggestions that Viacom deserves whatever happens because it refused to testify at the House Oversight Subcommittee hearing to explain its transaction and further failed to provide the Ways and Means Committee with promised documents demonstrating its reliance on existing law.

Neither of these suggestions is accurate. At a meeting with Joint Tax and Ways and Means staff on January 19th which I attended, we were asked if we had any interest in testifying, although we were informed by the staff that the hearing would be on the merits of the minority tax certificate policy and not on our transaction. Because, as I noted earlier, our interest is in our transaction and we do not presume to be experts on the policy, we passed. Had we been told the hearing was to focus on our transaction and get Viacom, I can assure you we would have chosen to testify. With respect to the documents, we did offer to provide the Joint Tax and Ways and Means Committees with certain confidential corporate documents, such as Board resolutions and earlier drafts of the purchase agreements, to prove our reliance on existing law. We did, however, express some concerns about the public release of certain confidential materials in advance of required government filings. We were specifically informed by Ways and Means Committee staff that a confidentiality agreement would be acceptable and we were invited to draft a proposed confidentiality agreement. We submitted that agreement to the Committee on January 24th and have yet to receive a response. Our offer still stands, although in the interim much of the information has become public through required FCC filings.

Mr. Chairman, I will close with one final comment. This is a legitimate sale to a minority-controlled partnership which conservatively fits within the four corners of existing government rules governing tax certificates. Mr. Washington, the general partner, is an experienced cable operator who continues to manage and operate every other cable system he previously acquired pursuant to section 1071. Every facet of our dealings on this transaction have been by the book.

There have been 330 other minority tax certificate sales approved by the FCC since 1978, on average just under twenty per year. Each tax certificate application and the accompanying documents are made part of the public record, and the public is given the opportunity to comment. The FCC reviews and acts on each application. The issuance of tax certificates for sales to minority-controlled entities is clearly neither a loophole nor an accident. It is a long-standing government policy operating under rules and guidelines adopted by the FCC, rules and guidelines which Congress has annually, by statute, reinforced since 1987.

We are certainly aware of the political revolution which took place last November and we acknowledge the proper role of Congress to change tax policy. But, we submit that it is unfair and wrong, and sends a destructive message to the private sector, to adopt a retroactive effective date for the apparent purpose of penalizing a particular transaction entered into by specific, law-abiding companies in full reliance on existing government laws and policy.

Mr. Chairman, I appreciate the opportunity to testify and stand ready to answer any questions the Committee may have.

PREPARED STATEMENT OF HON. BOB DOLE

Mr. Chairman, I am pleased to see that we are making progress on securing passage of the 25 percent self-employed health insurance deduction.

As you know the House overwhelmingly passed this legislation and it is now the Senate's turn to keep the legislation moving.

It is estimated that 3.2 million unincorporated self-employed Americans would claim the deduction on their 1994 tax returns—that's about 30 percent of unincorporated business owners in the country.

The owners of "C Corporations" always count on a permanent 100 percent deduction for the cost of their health insurance premiums. Unless we pass legislation in short order, small business owners will have no deduction.

A Color Blind Tax Code

The 25 percent deduction for the self-employed appears to have taken a new profile—as is evident by the attention that at least one of the revenue offsets is producing—the repeal of section 1071.

Just yesterday, I wrote to the Chairman of the Small Business and the Labor and Human Resources Committees requesting that they convene hearings on programs within their jurisdictions that grant preferences to individuals on the basis of race, sex, national origin or ethnic background.

In my view we should ask two simple questions—what were the original purposes of the programs? And have these purposes been fulfilled?

Today's hearing will help us start that process. There has to be ways to expand opportunity for all Americans, without resorting to strategies that rely on providing preferences for individuals simply because they belong to a certain group.

And one further point—the tax code must be color blind.

I look forward to hearing from today's panelists.

PREPARED STATEMENT OF BRUCE FEIN

Mr. Chairman and Members of the Committee: I am grateful for the opportunity to testify in opposition to the tax certificate program of the Federal Communications Commission which fosters racism and squanders federal tax dollars. I urge the Committee to repeal the Commission's authority to promulgate such an ignoble and profligate scheme.

Last January 27, a House Ways and Means subcommittee hearing explored the Commission's tax certificate policy administered under section 1071 of the Internal Revenue Code that showers lavish tax savings on broadcast, cable, and personal communications service licensees who sell to minorities. The House of Representatives soon passed a bill to repeal section 1071. The provocation for the hearing and repeal vote speaks volumes.

On January 20, 1995, Viacom Inc. and Mitgo Corp., a company wholly owned by black businessman Frank Washington, and affiliates of InterMedia Partners announced an agreement under which the former will sell its cable systems serving 1.1 million subscribers to a partnership consisting of the latter for $2.3 billion in cash. Mr. Washington's Mitgo would be the general partner entrusted with managerial control over the partnership, but Washington himself would invest only $1 million in the transaction. The lion's share would be forthcoming from a subsidiary of cable colossus TeleCommunications Inc., one of the limited partners of InterMedia.

Viacom's profit on the sale is estimated at from $1.1 to $1.6 billion. Its tax savings with the F.C.C.'s tax certificate, which enables sellers to defer income tax on profits indefinitely, is projected at from $440 million to $640 million. And that awesome savings would be an F.C.C. reward for Viacom's racism in searching for a buyer! Congress should prohibit the Commission's ugly and unconstitutional return of Jim Crow albeit dressed in a different color.

Chief Justice Harlan Fiske Stone lectured in *Hirabiyashi* v. *United States* (1943) that: "Distinctions between citizens solely because of their ancestry are by their very nature odious to a free people whose institutions are founded upon the doctrine of equality." On that score, the Chief Justice anticipated Reverend Martin Luther King Jr.'s heralded "I have a dream" speech in which he blessed the principle that a person should be judged by the content of his character not by the color of his skin." Congress has embraced the consensus of that rainbow coalition in prohibiting any racial discrimination in the making of private contracts under 42 U.S. Code 1981. Senator Trumbell explained: "[T]his bill applies to white men as well as black men. It declares that all persons in the United States shall be entitled to the same civil rights, the right to the fruit of their own labor, the right to make contracts, the right

to buy and sell . . . [T]he very object of the bill is to break down all discrimination between black men and white men."

The tax certificate policy of the Federal Communications Commission makes a mockery of equal justice and the constitutional imperative of color-blindness. It rewards sellers of broadcast properties with enticing tax savings if the purchaser satisfies racial or ethnic criteria reminiscent of apartheid. Indeed disputes over minority or ethnic status may propel the Commission to rely on precedents of South Africa's Race Classification Board when apartheid was at its zenith. The substance of Commission's policy is bribery of sellers to discriminate against buyers whose only sin is to have been born white.

The justification for the racially discriminatory bribery is not help for the disadvantaged. If that were the case, buyers would be required to show disadvantage, and there would be no color bar to eligibility. Beneficiaries of the tax certificate policy, such as Bill Cosby, Dave Winfield, and Oprah Winfrey, share little resemblance to penurious Oliver Twist. And Frank Washington has been a beneficiary four times prior to the Viacom deal.

Neither is past racial discrimination the justification. If that were the case, the beneficiaries would be required to demonstrate that they have been so victimized, and whites who have suffered from discrimination would not be excluded.

Nor can the tax bribe be justified by enriching programming diversity. Purchasers are not required to promise or implement programming changes; politically correct skin color or ethnicity, simpliciter, is sufficient to trigger tax benefits; and, the minority buyer may sell after one year without penalty.

Within the human breast, the craving for profit is color-blind. It thus wars both with intuition and experience to assert that the race or ethnicity of a broadcast owner is pivotal to programming content. Programming is driven by profitability; thus, Hallmark Cards did not revamp the programming of stations purchased from Hispanic owners in markets with substantial percentages of Hispanic viewers. The F.C.C. itself has never been able to document any correlation between broadcast ownership and programming content. The reason for the failure is simple: there is no such thing as a "black," "Hispanic," "Asian," or other racially or ethnically identifiable viewpoint, except perhaps in the eyes of racists.

Blacks in the United States, for instance, are emphatically not ideologically fungible. Associate Justice Clarence Thomas holds views sharply discrepant from those of Jesse Jackson and Barbara Jordan. The views of Congressman Gary Franks clash with many in the Congressional Black Caucus. Tom Sowell's views are not echoes of Benjamin Hooks or Louis Farrakhan.

Ward Connerly, a black California businessman on the Board of Regents of the University of California, recently voiced objection to affirmative action programs as inequitable and unfair to certain people. He also expressed chagrin at the reflex encouraged by affirmative action to view him first and foremost as a member of a racial group, rather than as an individual. Do Mr. Connerly's opinions reflect a "black," viewpoint in the mind of the F.C.C.?

To assert the existence of such a viewpoint is to betray racial stereotyping that is more to be denounced than imitated. To paraphrase the eloquence of Justice Clarence Thomas in *Holder* v. *Hall* (1994), the programming assumptions behind the F.C.C.'s section 1071 tax certificate policy "should be repugnant to any nation that strives for the ideal of a color-blind Constitution." They presume all blacks think alike.

In any event, programming diversity is simply an F.C.C. pretext for practicing racial discrimination for its own sake, i.e., simply to seek some specified percentage of minorities in the telecommunications and broadcast industries, a practice nixed by the United States Supreme Court in 1978. That conclusion is irresistible in light of the Commission's extension of race-based tax certificates to transactions involving personal communications service licenses.

The fact that the tax certificate policy elicits hallelujahs within the business community is unsurprising. It is a coveted tax avoidance device, and when money is at stake constitutional or moral scruples are cast to the wind by the typical businessman. They earned no honorifics during the days of Jim Crow, the Freedom Riders and Bull Conner's dogs and hoses.

The tax certificate policy of the Commission is no more fiscally prudent than Mr. Macawber in *David Copperfield*. The amount of taxes lost in a section 1071 transaction is unrelated to the financial incentive needed to promote a Commission objective. That type of spend thriftiness is predictable. Unlike Congress, the Commission is unobligated to offset tax losses with any other revenues. Thus, its tax certificate program is like a free lunch at the expense of Congress. Especially at a time when a balanced budget is a popular credo, entrusting the Commission with power over federal revenues seems foolhardy.

The Commission's race-based tax certificate program would probably be held unconstitutional by—the United States Supreme Court. Its sole exiguous underpinning is the 1990—precedent in *Metro Broadcasting*, but only one Justice of the 5 member majority still sits on the Supreme Court. But there are legitimate alternative racially neutral methods of raising capital that would assist minorities in the purchase of broadcast properties. For example, persons with incomes below a stipulated level might receive an income tax credit for purchasing a broadcast outlet or be given a tax holiday for a specified number of years on income earned by the broadcast property. Since the percent of low-income minorities is greater than the percent of low-income whites, this scheme could be expected disproportionately to boost the fortunes of the former groups.

Congress clearly holds constitutional power to make a repeal of section 1071 retroactive under the *Carlton* decision of the Supreme Court in 1994. Whether it should exercise such power is a tough question. Generally speaking, the private sector should be permitted to rely on existing—laws in planning its business activities. Such stability in the Law reduces business risks and promotes investment. On the other hand, there may be special reasons of policy that would overcome the presumption favoring prospectivity in the law, or reliance interests in the private sector—which in the case of section 1071 would be Viacom and Frank Washington—may be thin. I urge the Committee to examine the retroactivity issue with sensitivity.

PREPARED STATEMENT OF MICHAEL HOROWITZ

Mr. Chairman and Members of the Committee: I am grateful for the opportunity to appear before you this morning for the purpose of testifying about the FCC's Minority Tax Certificate program.

I do so for the purpose of unqualifiedly calling for its repeal.

My testimony this morning is a culminating moment in a lifetime of engagement in America's historic civil rights struggle, including an extraordinary two years spent in the late 60's as a law professor at the University of Mississippi—when its first black students were admitted. During that period, I witnessed and participated in an effort which restored and strengthened America's mission as exemplar of the rule of law at its honorable best. I watched Federal judges ending the tyranny of the color conscious state in order to create a color-blind society. I saw many brave men and women risk their good names within their communities, and much more, in efforts to create a moral order in which one's race was a source of pride, never a means of official preference. In the process, our civil rights struggle helped make America, in our eyes and in the eyes of the world, what Lincoln knew us capable of being: the last best hope of mankind.

At root, America's civil rights movements and struggles were moral in character—and sought to bring our promise and opportunity to those who needed them most: to minorities suffering from discrimination which often trapped them in lives of poverty, fear, ignorance and disfavored status. In a world sadly filled with racial hatred, America showed the way.

Which brings us to this morning: An examination of a program which purports to fulfill America's commitment to civil rights by enriching two large corporations owned by wealthy white men in an amount estimated as ranging between $300-$500 million—doing so in simple exchange for their proffer of a reported $5 million "profit" to a black man already made wealthy from such payoffs.

This is not what Martin Luther King marched for, or what Hubert Humphrey and Everett Dirksen fought in the Senate for, or what East Europeans and Soviets dreamed of when they worked and risked all to achieve our freedoms for themselves and their children. Indeed, the program before this Committee today would be eerily familiar to those who lived in the latter regimes: one which, accompanied by high-flown moral rhetoric, rewards a privileged class of well-wired insiders. That the conduit-payee of the deal the Committee examines today was the person who shaped and ran it while a Government official only heightens the parallels between the program's debasement of principle and similar debasements all too familiar to any Bulgarian or Albanian. It is the final scene in Animal Farm, not the Tax Code or any FCC report, which best describes the program before this Committee.

I appear before this Committee as a committed political conservative, one who served during the Reagan Administration as OMB General Counsel. As such, I come before the Committee to acknowledge the equal culpability of many conservatives in such enterprises as the FCC's Minority Tax Certificate program. American conservatives have long—and properly in my judgment—spoken out against the debilitating effects of welfare. With equal propriety, we have argued that earned rewards

not government entitlements are the only enduring and ultimately productive means of income distribution—that marketplace lessons and success, not money taken from the public fisc, must be the sole means by which work and entrepreneurship is rewarded.

We conservatives have generally meant what we have said in this regard—but all too sadly, we have often sought to act on our convictions only when poor people have been the objects of welfare spending. On the other hand, we have frequently taken different positions on welfare spending when welfare hustlers come to Washington wearing three piece suits. Thus, it was during the otherwise highly successful tenure of my friend Mark Fowler that the Section 1071 program was expanded, both to include cable system sales (See, *Statement of Policy on Minority Ownership of CATV Systems*, 52 R.R.2d 1459 (1982)) and to allow tax certificate issuances on the sale of acquired interests (See, *Commission Policy Regarding The Advancement of Minority Ownership in Broadcasting*, 92 FCC 2d 849(1982)). (Knowing Mark Fowler as I do, I may be quite unfair to him here; it would not surprise me if pressures on him from within the FCC and from Congress were not critical factors in his 1982 support of the Section 1071 program expansion.)

Debasing as it does the moral meaning of civil rights, Section 1071's welfare for well-wired minority "representatives" is bad enough. But the program—and many of today's affirmative action programs—debase our public policy in additional ways:

- Their subsidies come from American taxpayers—doing so in an era of acute fiscal stringency;
- They complicate the Tax Code precisely at a time when Congress—largely through the leadership of this Committee—has struggled to simplify it and strip it of narrow, special interest provisions;
- They encourage liberal-conservative logrolling of the worst and deeply immoral sort: liberals spike their guns in debates over race and welfare in exchange for payoffs to their financial supporters, and conservatives who are (or at least were) often wrongly demonized for their civil rights views gain a measure of safe harbor political protection on the issue;
- Their prime welfare component goes to large corporations and wealthy white men;
- They don't work.

Before discussing the particular failures of the Section 1071 program, a brief word may be in order about one of the beneficiaries of the deal which brought the program to the Committee's attention. TCI president John Malone has long seemed to me a superb model of the American businessman. He and others created the cable industry, largely without government support, reportedly in part because of their distaste for the regulated and government-dependent character of television networks. The cable industry has been hurt of late by what I believe to be highly perverse Federal rate regulation, and the Section 1071 program was (to the best of my knowledge) not created by Mr. Malone or the cable industry. Taking the rules as they found them, it must seem ironic to TCI and Viacom executives that the one Federal rule which seemed to put subsidy money in their pockets became the rule which is now under attack. I nonetheless believe it highly likely, from all I have read of Mr. Malone in particular, that he would be the first to acknowledge the folly of using non-productive government counter-subsidies as appropriate means of balancing inappropriate regulation. The fact that the Section 1071 rules were on the books when TCI and Viacom sought to use them only serves to prove the Michael Kinsley aphorism: that what's often scandalous about Washington is not illegal conduct, but what's done legally. Sadly for TCI and Viacom, their opera wasn't over when the public policy scam which had subsidized comparable deals caught the front pages. During the House debate, not a single voice was raised to defend their deal, and I can think of no serious basis on which that deal can be rationalized or salvaged.

What of the program before the Committee, of which it was said during the House debate by its principal floor sponsor: "nobody says [it] has been a roaring success?"

- Despite costing American taxpayers a reported $2 billion over its twenty-year history, the Section 1071 program cannot even be said to have increased minority ownership in the communications industry. The modest growth in minority ownership during the life of Section 1071 is (even accepting current designations of minority owners as accurate) "far more rationally attributable to the growth in wealth in the minority community than to th[e] program." (This from Representative Nancy Johnson, a moderate Republican, during the House debate.)
- Such findings as may exist about minority ownership are further vitiated by the short-term, revolving door character of minority "ownerships" generated by the

Section 1071 program. Examining all of the FCC tax certificates issued for radio properties under Section 1071 from the program's inception, fewer than 30% were still held by their minority "owners" at the end of 1992—itself a highly inflated number in light of the fact that 1992 transactions were utilized in calculating the 30% figure. In other words, current snapshots of minority ownership do not account for the fact that many of the even the modest number of minority "owners" who do exist can be expected to soon sell their interests and to be followed by new "owners" who themselves will shortly be cashing out their roles as conduits between real buyers and real sellers.

As noted, the Section 1071 program has been, in the words of Representative Dick Zimmer, another moderate Republican, "basically a subsidy for rich white people." Prime beneficiaries of FCC tax certificate issuances have included such people as four-time recipient Jack Kent Cooke (reportedly personally enriching him by tens of millions of dollars) and such institutions as the Times-Mirror Corporation which in 1993 received a tax break of $35-$80 million for selling four TV stations to a partnership whose principal minority partner invested $153,000 in borrowed money. (Rich black people have also been subsidized by Section 1071 tax certificates; the program has also enriched such millionaire investors as Oprah Winfrey, Bill Cosby and Dave Winfield.)

The Section 1071 program is also Constitutionally suspect, given the fact that the prime premise of the Supreme Court's bare-majority, unenthusiastic decision *Metro Broadcasting v. FCC*, 497 U.S. 547(1990), was based on a deference to FCC "expertise" that a nexus exists between minority ownership and programming diversity. In fact, whatever the appropriateness of the *Metro Broadcasting* test, no serious confirmation of the actual existence of that nexus exists. As noted by Jonathan Rauch in a scathing article, "Color TV: Diversity Mongering at the FCC," which recently appeared in The New Republic:

> [T]he rationale depends on the assumption that minority-owned stations do more "minority" programming, by whatever definition. This assumption turns out to be unsupported. "Content analyses done over the last fifteen years show really very small differences," says Jorge Reina Schement, a communications professor at Rutgers University. Minority-owned stations need to make money and maximize ratings, and "they operate in the same marketplace everyone else operates in." Another expert, George Washington University's Christopher H. Sterling, agrees. "What research has been done so far comes up showing no significant difference."

Shockingly, but characteristic of its "insider" status, an FCC effort to determine the constitutionality-in-fact of the Section 1071 program was barred by a Confessional appropriations rider. Thus, the FCC has not even been able to study much less validate whether the program is complying with the Constitution. So much for the FCC "expertise" to which *Metro Broadcasting* deferred.

In fact, as Rauch points out, "you don't hear much talk any more about programming diversity," and that "without fanfare, 'programming diversity' has been more or less dropped in the wastebasket . . . while ethnic representation is now viewed as an end unto itself."

Rauch also questioned the *Metro Broadcasting* majority rationale, doing so in terms which I believe to be compelling:

> No one has any clear idea of what constitutes "minority views"—a concept apparently implying that people think with their skin or their gonads. No one has objectively demonstrated a lack of minority or female views on the air. No one has figured out just what constitutes minority programming, unless it is whatever programs minority members tune in.

But even if Rauch is wrong, and minority ownership triggers the socially compelling outcome of "minority programming," two points need to be made.

First, defining minorities is a seamless and ultimately impossible task which also is highly divisive and dangerous: As Chairman Archer put it during the House debate:

> The minorities favored under the FCC tax certificate program are black, Hispanic, Asian, Alaska Natives and American Indians. Does it make any sense for our tax laws to be used to favor one person because he is African American or Asian while disfavoring another because he is white? Does this not in fact drive a wedge in our society between people based on racial and ethnic grounds?
>
> Under the FCC's policies a family descended from Spanish Jews, forced from Spain in 1492 by Ferdinand and Isabella, thereby qualified for the minority tax certificate program because they were judged by the FCC to be Hispanic. Yet non-Hispanic Jewish Americans perhaps driven from Europe by the Holocaust do not qualify. Is this not exactly the kind of racial and ethnic wedge the proponents of Section 1071 say they are worried about? But [Section 1071] would

continue this. What is a minority? Should the FCC look into the family tree as to the ancestors of every American before determining whether they qualify or not?

Next, even if this Committee were capable of dismissing Mr. Archer's trenchant questions, and of ignoring Section 1071's sorry record of misplaced subsidies, revolving-door ownerships, conduit payoffs and the non-performance of its stated goals, repeal of the program would still be clearly in order. Senator Packwood's question to the panel—whether there are "alternatives to make capital available to minorities who wish to acquire media properties"—can be answered, in significant part, by vigorous enforcement of lending discrimination statutes when qualified minority borrowers are disfavored for loans while equally qualified non-minority borrowers receive them. While I doubt that such discrimination is now systemic, it may well be that a measure of study is in order to determine if it exists.

During the course of my tenure as OMB General Counsel, and since, I have witnessed the extent to which counting-by-race affirmative action programs provide limited benefit to their alleged beneficiaries while—again to use Dick Zimmer's striking terms—they do provide benefits to "rich white guys." Thus, while examining the performance of the Labor Department's OFCCP program, the largest Federal affirmative action program and one which deals with almost 100,000 contractors and covers approximately 25% of the American labor force, it became clear that OFCCP-covered firms did not do appreciably better and in many instances did worse in their minority employee hiring and promotion records than did non-OFCCP covered firms. (This analysis dealt with the OFCCP program during its alleged Carter Administration heyday period.) On the other hand, the OFCCP program generates no less than $2 billion per year in legal fees, probably much more, which go to downtown, generally white law firms engaged in an endless process of crafting, drafting and negotiating safe harbor "plans." In addition, the OFCCP program has fostered affirmative action bureaucracies within corporate America which are filled by generally well-wired, highly educated minority employees. (The Urban League once wrote a report, which it quickly withdrew from public circulation, decrying the fact that affirmative action programs created gold-plated minority niches in personnel offices, at the expense of minority interest in and service in the more important areas of private sector employment.)

Today's hearing, of course, deals with the Section 1071 program, not the broad range of affirmative action programs which both the Senate Majority Leader and the President have scheduled for public review and debate. But there is none worse, none which so nakedly gives subsidies to the rich, none which so clearly fails to achieve its stated objectives, none which is more constitutionally suspect, none which gives revolving-door, Washington-insider, business-as-usual politics a worse name.

Rapid repeal of the Section 1071 program, as the House has done, is in my view clearly in the public interest. I very much hope this Committee will take the necessary steps to achieve this important public policy objective.

PREPARED STATEMENT OF ROY HUHNDORF

Mr. Chairman and Members of the Committee, thank you for allowing me to testify before the Committee. My name is Roy Huhndorf and I am Chairman and CEO of Cook Inlet Region, Inc. ("CIRI"). On behalf of our Native American shareholders, I am honored to present to you our view on the Minority Tax Certificate Program administered by the Federal Communications Commission ("FCC" or "Commission").

I. INTRODUCTION

CIRI is an Alaska Native Corporation owned by approximately 6,700 Native Americans of Athabaskan, Eskimo, and Aleut descent. Our shareholders reside in 47 states. A majority of our shareholders are women.

Like Native Americans generally, our shareholders suffer from a scope and degree of health, social and economic problems unknown to the general population in this country. Over one-third of our shareholders live below the poverty level. Over the past decade, CIRI has been recognized as one of the nation's leading minority-owned broadcasters, and the largest Native American-owned broadcaster. CIRI has utilized the FCC's Minority Tax Certificate Program and in so doing, has consistently and demonstrably upheld the Commission's minority ownership policies. It has also strenuously advocated stricter enforcement by the FCC of its own rules. CIRI's shareholders have a large stake in the legitimate uses of tax certificates and we welcome Congressional attention to both the significant merits and to the abuses of the program.

Accordingly, CIRI supports a review of the manner in which the FCC has issued tax certificates in transactions involving minority investors in communications properties. We believe that abuses of the tax certificate program exist, and that they stem from inadequate standards and enforcement by the FCC to determine whether a proposed minority investor is merely a "front" for a larger non-minority-owned communications company. We also wish to stress that the underlying tax certificate program is an appropriate and Congressionally approved policy, and we would implore Congress to be careful in its review of the program not to "throw the baby out with the bath water."

II. TAX CERTIFICATE BACKGROUND

The FCC derives its authority to issue tax certificates from Section 1071 of the Internal Revenue Code. Congressional oversight of the authority of the FCC to issue tax certificates in connection with transfers of FCC licenses to minorities is now long-standing. The overall policy has been repeatedly affirmed and ratified by Congress. We believe the policy is a legitimate and well-recognized exercise of the Commission's power as provided by Congress.

The fundamental legitimacy of the policy is based on the undeniable fact that there is a significant under-representation of minorities in ownership of broadcast and cable licenses in this country. Those licenses are part of the public trust of a finite resource administered by the federal government. Minorities simply have not shared in this distribution over the past half-century and today. This phenomenon exists and is part of a burden of social and economic discrimination. Tax certificates have made a difference in correcting this. They have served as a meaningful incentive to those selling broadcast stations and cable systems to seek minority buyers. In mature industries like television, radio, and cable, where license values have been run up substantially, use of tax certificates is one of the few ways to correct this historical fact of discrimination. In 1978, when the tax certificate policy was adopted, minorities owned just less than one-percent of such stations. As of 1993, minorities owned approximately three-percent of all radio and television stations. A three-fold increase is significant. That level of increased participation in these key national industries would not have occurred without the availability of certificates.

We also like the tax certificate concept because it is a private sector, self-help program. If properly administered, it relies on real capital, real business management, and real business risk and reward to promote participation by an historically excluded group. Incentives, but not hand-outs.

III. PROBLEMS WITH TAX CERTIFICATE ADMINISTRATION

At the same time that we note to you that tax certificates are necessary to correct a long-term pattern of exclusion in the ownership of FCC licenses, I also want to note that the program would have been significantly more effective—in the long run—if its abuses had been eliminated rather than encouraged.

When a tax certificate is issued for a highly leveraged and minority-fronted transaction, three events typically occur: First, despite paper formality, the minority owner typically has little real control and exercises even less over the enterprise. Second, the minority owner exits the scene rapidly. Third, sales of stations to legitimate minority interests who wish to stay in the business and who seek to expand the real role of minorities in the industry are severely undercut. The ability of minorities to obtain tax certificates by "fronting" purchases may serve the non-minority financial backers of such deals but the legitimate users of tax certificates are adversely affected.

Under the current FCC process, when a tax certificate is used by a fronted investment group, the profits realized from the certificate generally go to the benefit of large, non-minority corporate partners. The fronting entity (usually owned by one or a small handful of minority individuals) are rewarded on the basis of a small piece of true economic ownership that has been "flipped." It is difficult to understand how the Tax Certificate Program, as so administered, can consistently advance minority ownership or programming diversity.

In contrast to the above, when CIRI has utilized a tax certificate it has (i) committed real equity capital commensurate with the size of the deal, (ii) has exercised real control, (iii) has committed significant resources to further—and in fact achieved—diversity in viewpoint and involvement in the community which it serves and, (iv) has had long ownership periods (averaging 7-plus years). We believe there are other, equally bona-fide, minority-owned companies that have utilized that tax certificate in a similarly legitimate way. The profits, if any, earned over time from owning such a property are used to provide the most basic income needs—such as food, shelter, clothing and social services—for our 6,700 Native American shareholders.

One transaction which recently received a tax certificate is, in our view, a paradigm of the unfortunate side of the tax certificate process. In 1993, the FCC issued a tax certificate for the sale to the Times Mirror Corporation, a very large media and communications company, for the sale of four broadcast television stations to an investment consortium organized by a Wall Street firm. The price was $320 million.

The involved minority (an individual who had been an employee of the buyer) put up $153,000. According to press reports the majority of that was borrowed. This was in turn leveraged on a 10,000:1 basis. The minority interest was subject of a call after one year.

CIRI filed an objection with the FCC, asking it to further review this transaction and not issue a tax certificate. The Commission summarily rejected our views. We believe the Commission missed an important opportunity to tighten up a beneficial program and make it more effective. Instead, it opened the door further to transactions of this nature.

We have recently filed with the Commission an objection on similar grounds to the Viacom transaction, which we are aware is a matter of scrutiny by the Congress.

IV. RECOMMENDATIONS

Despite the problems of abuse with tax certificates,we believe that program serves an absolutely essential purpose in promoting the entry and growth of minorities in telecommunications, an industry in which minorities are disproportionately underrepresented. Congress has repeatedly declared that minorities should be assured meaningful participation in communications services. Congress' goal, we believe, has been to ensure the participation of groups that are "disadvantaged" by the presence of unique barriers to their participation in the communications industry. Minority tax certificates, if properly administered, are an effective vehicle to achieve that purpose.

Specifically, CIRI urges this Committee and Congress to direct the Commission to eliminate abuses in the program. Specifically, we recommend five key steps: First, the program should be made more race-neutral and economically-based by requiring that, in addition to being a member of an under-represented minority group, a qualifying entity should also be "disadvantaged." This should be based on a standard that requires demonstration that the applicant (or its equity owners) suffer from genuine economic and social disadvantages.

Second, the disadvantaged entity should have clear and actual control over the purchasing entity. Such dejur factors as true managing general partner status, (or at least 50.1% of voting stock in the case of a corporation) should be required, as well as de facto conditions such as real decisionmaking and real accountability.

Third, the disadvantaged entity should have a real equity stake in the enterprise. Leveraging up a capital structure on minimal funds is a significant index of fronting.

Fourth, certain "hallmark" elements in an organizational structure which call into question the minority partner's current and continued involvement in the entity should disqualify the entity. For example, if non-minorities have the ability to "call" the minimum minority equity stake, the purchasing entity should not be considered eligible for a tax certificate.

Fifth, the Commission should make clear in writing that if the purchasing entities' statements are found to be false, incomplete, or misleading (by omission or commission) the entity (and its principals) will be subject to substantial penalties—both civil and criminal—as well as being disqualified from applying for any Commission licenses in the future. This standard might also be applied to lawyers practicing before the Commission and presenting tax certificate applications.

Finally, to assure responsiveness to the Committee's inquiry, the Commission should be directed to respond immediately to this "tightening up" endeavor, before any further tax certificates are awarded.

A rigorous application of their criteria will eliminate shams and limit the program's effect from a tax revenue standpoint. Accordingly, we do not believe that outright caps be on the program are needed. To cap the tax certificate application would limit qualified minorities to opportunities in only the lower tier of markets. In conclusion, CIRI fully supports the efforts of Congress and the FCC to oversee and implement processes that allow historically disadvantaged groups to participate at the ground level in the broadcast and cable business. The Tax Certificate Program administered by the FCC has tremendous importance and potential but, due to lax administration, the Program has suffered from significant abuses and erosion of credibility.

DEALS / ALLAN SLOAN

Minority Buyer Means Big Tax Benefit for Times Mirror in Sale of TV Stations

Want to see how to take advantage of a well-intentioned but silly regulation—and save millions of dollars in income taxes while being pro-diversity at the same time? Then watch how Times Mirror Co. is selling its four television stations to a company called Argyle Communications.

Times Mirror—which also owns Newsday, my employer, and the Los Angeles Times—is selling the stations to Argyle for $335 million in a deal that seems to be straight out of the debt-happy 1980s. Argyle's stockholders are putting up only $300,000 of the $335 million, or less than one-tenth of 1%. The other 99.9%-plus consists of borrowed money. Think of it as buying a $100,000 house with an $896 down payment.

But fear not. In reality, the deal is nowhere near as odd as it seems. It is set up the way it is so Times Mirror can get a tax certificate by selling its stations to a company at least 51% owned by an accredited minority investor. By making such a sale, Times Mirror can avoid having to immediately fork over the $80 million or so in capital-gains tax that it would normally owe Uncle Sam on the sale of the stations.

The financial structure of Argyle, a start-up company based in San Antonio, actually is rather ingenious.

By having only $300,000 worth of stock, Argyle can be 51% owned by Ibrahim Morales, a naturalized Cuban refugee who's putting $153,000 of borrowed money into the deal. Under Federal Communications Commission rules, Times Mirror can get its tax certificate, as long as Morales remains Argyle's 51% stockholder for at least a year.

In the real world, however, Argyle has an additional $49.7 million of capital, most of it from a leveraged-buyout fund assembled by the New York investment banking house of Donaldson, Lufkin & Jenrette Securities Corp. I don't know how many of these investors are accredited minorities, but if there are many, I'd be surprised.

If all Argyle's holders convert their securities into common stock, DLJ will own about 85% of Argyle; investors led by Bob Marbut, the former head of Harte-Hanks Communications, will own about 14%, and Morales will own 0.3%.

Before we go any further, you should know that my family and I are indirect beneficiaries of this deal, because Times Mirror stock is one of our biggest investments.

While I find it absurd to give Times Mirror a huge tax break because Ibrahim Morales is anteing up $153,000 of Argyle's $50 million of capital, I can't blame anyone involved for taking advantage of the rules.

Times Mirror, as a publicly traded stock, has an obligation to get the best after-tax price it can for its stations. DLJ is in business to make money. And Marbut and Morales, who are trying to build a broadcast company from scratch, would be foolish not to take advantage of a chance to buy Times Mirror's stations for less than they would presumably pay if this were not a tax deal.

There have been hundreds of these deals in the 15 years since the FCC adopted its tax certificate program, and this one actually is less offensive than many others.

In a series of conversations with Morales, Marbut and other players in the deal, it became clear that Morales actually will play an active role in managing Argyle. He is a vice president at the Katz Communications advertising sales company in New York and has been in the TV advertising business for more than 20 years. That distinguishes this deal from others in which minority group members hired non-minority "advisers" to run the properties they "controlled," took a quick payoff from and left.

Morales, in fact, has the option of leaving anytime after a year and getting $1 million of preferred stock in exchange for his common stock. And DLJ can kick him out anytime it wants by giving him $1 million of preferred stock. But Morales said he has no intention of making a quick exit.

Marbut and Morales both say Morales was part of Marbut's original investor group before anyone realized the benefits he could produce by virtue of being Latino. "We didn't know that when we started," Marbut said.

Thomas Unterman, Times Mirror's general counsel, said the company is selling to Argyle because Argyle's was the best after-tax offer Times Mirror got. "We have a duty to our shareholders to maximize our return, and we encourage diversity of ownership in the media," Unterman said.

Unterman also took some issue with my $80-million figure for Times Mirror's tax saving.

To greatly oversimplify, avoiding capital-gains tax on Times Mirror's $235 million or so in profit on the sale of the stations will lower tax deductions Times Mirror would otherwise get. Unterman said the net benefit will be from $35 million to $50 million, depending on what Times Mirror does with the sales proceeds.

As a shareholder of Los Angeles-based Times Mirror, I'm perfectly happy to get my share of $35 million or $50 million or whatever Times Mirror is saving from this tax certificate. As a taxpayer, however, I'm appalled.

Once again, I'm afraid, the major beneficiary of a well-intentioned social program is a rich, white-controlled corporation, rather than the people the program is supposed to be helping.

ALLAN SLOAN is a financial columnist for Newsday in New York.

PREPARED STATEMENT OF ROBERT L. JOHNSON

Mr. Chairman, members of the Senate Finance Committee, my name is Robert Johnson, I am the founder and Chief Executive Officer of Black Entertainment Television (BET) Holdings, Inc. BET Holdings, Inc. is a multi-media company whose principal business is the operations of the BET Cable Network, a basic cable programming service that reaches 40 million cable households.

In 1991, BET Holdings became the first black-owned company to be publicly traded on the New York Stock Exchange. From an initial investment of $500,000 by Tele-Communications, Inc. (TCI) in 1980, BET Holdings celebrates its 15th Anniversary with a market capitalization of approximately $350 million dollars and annual revenues in excess of $100 million.

I am pleased to have this opportunity to share my views on the question of should there be a minority tax certificate program to encourage minority ownership of media properties. My answer is yes. Section 1071 of the IRS Code should remain in effect until we as a nation have come to grips with this fundamental question: Why do we, in the most capitalistic economy on the globe, have to pass laws, propose regulations or provide incentives to get white businessmen to do deals with black-owned business?

The answer is as simple as it is tragic. I believe that most whites of goodwill will do business with anybody who has the required capital. The reason they don't do business with blacks is we simply don't have the capital or access to the capital to be an equal player in the free enterprise marketplace of this economy. How the Congress and the Administration, working together, can solve this problem of "capital haves and have nots" should be the real subject of this hearing.

The tax certificate program is nothing more than the common and accepted use of tax policy to achieve a desired social end; i.e. minority ownership and diversity of ideas resulting from ownership diversity. It is the same in theory as the home ownership tax deduction. Tax deduction for home mortgage is a way of using tax policy to encourage home ownership and asset accumulation, both laudable public policy goals. But you would say the home ownership deduction is not race specific, it is race neutral. In other words, its a level playing field regardless of race.

Perhaps it is and perhaps it isn't if you realize that blacks are more likely to be turned down for mortgage loans than whites of the same economic profile. The fact of the matter, what is not level and what has never been level in the over 200-years of this nation's history is the economic playing field of capital accumulation and access to capital for black Americans because of institutionalized racial and economic discrimination.

I propose that this Committee focus on changing that glaring inequity rather than getting bogged down in a political fight over affirmative action of which the tax certificate program that if seen in its worst light is a bribe to white businessmen to do business with blacks and an insult to black businessmen for not having the financial resources to compete as equals.

Here are my suggestions for creating a level playing field in the game for access to capital where the important color is green not black or white:

(1) Reduce the Capital Gains Tax. A reduction in the capital gains tax would release billions of dollars into the U.S. economy which would benefit all Americans. I am convinced that some of that capital would flow into the hands of minority entrepreneurs who are now in search of capital and who have the ideas and the work ethic to pursue their dreams.

I suggest we go a step further. Eliminate entirely the capital gains tax on income resulting from investments, either equity, including stock purchased, or debt in companies and small business that are located in economically depressed areas or areas to be designated as enterprise zones. In other words, if the risk is greater, make the reward greater. A targeted capital gains tax would do that and create economic development in depressed areas through entrepreneurial initiatives rather than government subsidy.

(2) Allow for a 50 percent reduction in the estate tax of those individuals whose recipients invest 50 percent of their estate value in businesses that are headquartered in and have over 50 percent of their employees in economically disadvantaged areas.

This would achieve two important goals. One, black companies would continue to thrive as their heirs reinvest from their estate into their own business. Two, capital would be redistributed in such a manner that would result in a net increase of capital into economically deprived areas rather than the current net outflow.

This estate tax credit program could become institutionalized by the participation of banks and mutual funds. The profits from those investments would be taxed at a nominal capital gains rate of say 5 percent.

(3) Eliminate the Small Business Administration and utilize those funds (approximately $750,000,000) to create an Urban Enterprise Development Bank. The Bank would be capitalized by the Federal Government, but would operate as a public company like Fannie Mae, with a charter to provide the financial foundation for greater bank lending in the inner cities.

The bank could also invest in venture capital funds that direct their investments into enterprise zones.

You will note that none of these proposals is tied to race or is race specific. But let us not forget that a change in racial attitudes is critical to solving the problem of capital formation in the black community. In other words, whatever solutions we propose, be it tax certificates or targeted capital gains tax reduction, White America must buy into the urgent necessity for these programs if they are to have any chance of success. Fundamentally, white Americans must understand the interdependency between black economic empowerment and the quality of the standard of living of this nation. We cannot have one without the other.

Prepared Statement of William E. Kennard

Chairman Packwood and Members of the Committee: Thank you for the opportunity to explain how the Federal Communications Commission has used Section 1071 of the Internal Revenue Code to further the FCC's and Congress' policies.

I. INTRODUCTION AND OVERVIEW

Section 1071 of the Internal Revenue Code authorizes the FCC to permit sellers of broadcast properties to defer capital gains taxes on a sale or exchange if the sale or exchange is deemed by the agency to be "necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations." 26 U.S.C. §1071.

Section 1071 was enacted in 1943 to alleviate the hardship of involuntary divestiture associated with the Commission's newly adopted multiple ownership rules. Those rules limited radio licensees to ownership of one outlet per market, and, as a result, some broadcast licensees were required to sell overlapping stations. Later, tax certificates were used in voluntary transfers as an incentive to licensees to divest themselves of properties grandfathered under another provision of the multiple ownership rules which limited the number of stations a single entity could own nationwide.

Since that time, the FCC has used tax certificates in other contexts to further the goals of national communications policy. Today, the FCC issues tax certificates to encourage:

- licensees to come into compliance with the FCC's multiple ownership rules
- microwave licensees to relocate to other frequencies to facilitate licensing of personal communications services
- owners of AM radio to divest themselves of licenses in certain frequency bands to reduce interference
- minority ownership.

I understand that this Committee is most interested in the FCC's use of tax certificates to promote minority ownership of broadcasting stations and cable television systems so I will focus on that area in my testimony today.

II. THE FCC'S MINORITY TAX CERTIFICATE POLICY

A. Development of the Policy

Recognizing that the viewing and listening public suffers when minorities are underrepresented among owners of broadcast stations, the Commission began working to encourage minority participation in broadcasting in the late 1960s. Its first step was to formulate rules to prohibit discrimination in hiring and, several years later, in response to a court decision, it began to consider minority status in comparative licensing proceedings.

The decision to grant tax certificates in sales involving minority buyers was prompted by requests from the broadcasting industry and others in the late 1970s. In 1978, the Commission's Minority Ownership Task Force reported that although minorities constituted approximately 20 percent of the population, they controlled fewer than one percent of the 8500 commercial radio and television stations then operating in the United States. Thus, the National Association of Broadcasters (NAB) proposed that the FCC establish a minority tax certificate policy to provide

incentives for established broadcasters to sell radio and television stations to minority entrepreneurs.

The Commission agreed with NAB that underrepresentation by minorities contributed to a dearth of representation of minority views over the public airwaves. The Commission determined that an increase in ownership by minorities would inevitably enhance the diversity of programming available to the American public. Therefore, in 1978, the Commission issued a policy statement in which it determined that it would grant tax certificates to licensees that assign or transfer control of their authorizations to minority-controlled entities. *Statement of Policy on Minority Ownership of Broadcasting Facilities,* 68 FCC 2d 979 (1978).

In 1981, the Chairman of the FCC, Mark Fowler, began a review of the Commission's minority ownership policies with the goal of finding new ways to advance minority ownership. To assist in this effort, he established the Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications. The Advisory Committee identified lack of access to capital as the largest obstacle to minority ownership and identified the tax certificate as a successful way to enable minorities to attract financing.

As a result, the Commission, by a unanimous vote, took a number of steps in 1982 to make the tax certificate policy more effective in providing meaningful opportunities for minorities to enter the communications business.

First, it extended the tax certificate policy to sales of cable television systems. The Commission determined that cable operators, like broadcasters, exercise discretion in determining which broadcast and non-broadcast signals they will carry and, thus, taking steps to increase minority ownership would help to ensure that the viewpoints of minorities are adequately represented in cable television system programming.

In expanding the tax certificate program to cable systems, Chairman Fowler emphasized in a separate statement endorsing the Commission's decision that such actions aim squarely at the problem of minority financing opportunities. Mr. Fowler noted: "As President Reagan has said, the best hope for a strong economic future rests with a healthy, growing private sector. And the private sector does best when all have opportunities to enter it." *See Statement of Policy on Minority Ownership of CATV Facilities,* 52 R.R.2d 1469 (1982).

Second, the Commission modified the policy to allow issuance of tax certificates to investors in a minority-controlled broadcast or cable company upon the sale of their interests, provided that the interests were acquired to provide "start-up" capital to assist the company in acquiring its first broadcast or cable facilities. *Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting,* 92 FCC 2d 849 (1982). The Commission found that by broadening the tax certificate policy in this manner "the pressing dilemma minority entrepreneurs face—the lack of available financing to capitalize their telecommunications ventures—is met and a creative tool of financing is created."

In 1990, the FCC's minority ownership programs were upheld as constitutional by the United States Supreme Court. The Court held that the Commission's policies designed to increase minority ownership were substantially related to the achievement of a legitimate government interest in broadcast diversity and that they did not impose an impermissible burden on nonminorities. *Metro Broadcasting, Inc. v. FCC,* 497 U.S. 547 (1990). The Supreme Court cited numerous empirical studies demonstrating that there is a nexus between minority ownership and increased program diversity. Although the Court decision did not specifically involve tax certificates, the rationale for the decision clearly applies to this program.

B. Legislative Constraints on Changes to the Minority Tax Certificate Policy

Late in 1986, the Commission commenced a proceeding to determine whether its minority ownership programs were appropriate as a matter of policy and constitutional law. It asked for public comment on a number of issues, including whether the Commission should continue to grant preferences to minorities and what social or other costs might result from the policies. *Reexamination of the Commission's Comparative Licensing, Distress Sales and Tax Certificate Policies Premised on Racial, Ethnic or Gender Classifications,* 1 FCC Rcd 1315 (1986).

Congress reacted to the Commission's attempt to reevaluate its minority ownership policies by attaching a rider to the FCC's 1988 appropriations bill explicitly denying the Commission authority to spend any appropriated funds "to repeal, to retroactively apply changes in, or to continue a reexamination of, the policies of the Federal Communications Commission with respect to comparative licensing, distress sales and tax certificates granted under 26 U.S.C. 1071, to expand minority ownership of broadcasting licenses . . . ." Congress also ordered the Commission to terminate the proceeding reexamining its minority ownership programs and to reinstate

the prior policy. Pub. L. No. 100-202, 101 Stat. 1329 (1987). This rider has been re-enacted by Congress each year since 1988.

In the 1994 appropriations legislation, Congress clarified in the House Conference Report that the prohibition on reexamination is "intended to prevent the Commission from backtracking on its policies that provide incentives for minority participation in broadcasting" but that it "does not prohibit the agency from taking steps to create greater opportunities for minority ownership." H. Conf. Rep. No. 103-708, 103d Cong. 2d Sess. 40 (1994) (emphasis added). Therefore, the Commission has been greatly constrained in its ability to review the administration and effectiveness of the tax certificate program.

C. Administration of the Tax Certificate Program

Because the rider to the FCC's appropriations bill prevents the Commission from spending appropriated funds to impose limitations on the minority tax certificate program, the Commission must consider tax certificate requests in accordance with the policy as it was in effect in 1986, subject only to changes that would expand the policy.

A tax certificate allows a seller to defer capital gains taxes incurred in the sale of a communications property. Under Section 1071 of the Internal Revenue Code, this deferral can be accomplished by treating the sale as an involuntary conversion under 26 U.S.C. § 1033, with the recognition of gain postponed by the acquisition of qualified replacement property, or by electing to reduce the basis of certain depreciable property, or both.

Thus, the certificate provides incentives to licensees to sell to minority entrepreneurs, while at the same time enhancing the buyer's bargaining position and ability to attract capital. Section 1071 also encourages reinvestment in communications infrastructure by requiring the seller to reinvest the gains from a tax certificate transaction in similar property.

A request for a tax certificate is submitted to the Commission in letter or petition form. The request is usually filed in conjunction with a sale and, thus, the parties also are required to submit applications for consent to assign or transfer control of the relevant licenses. Ownership information about both the seller and buyer is contained in these applications, and any interested party may oppose the grant of the tax certificate or of the sale.

To qualify for a tax certificate, the minority buyer must demonstrate that minorities have voting control of the company that is purchasing the broadcast station or cable system, and that they own more than 20% of the company's equity. Minorities must maintain both legal and actual control over the operation of the business. The Commission evaluates these criteria to determine whether issuance of a tax certificate is warranted. Many requests for tax certificates have been denied or withdrawn because the proposed transaction did not meet FCC standards.

The minority status of individuals is determined by reference to the Office of Management and Budget's ethnic group or country of origin classifications. Qualified minority groups include African Americans, Hispanics, American Indians, Alaska Natives, Asians and Pacific Islanders.

The Commission reviews applications and tax certificate requests carefully and often asks the parties for additional information. The Commission has denied grant of tax certificates when the parties failed to demonstrate minority control or to satisfy other criteria. If the Commission determines that grant of a tax certificate is warranted under its tax certificate policies and prior tax certificate decisions, it will issue the certificate to the seller, which in turn submits it to the Internal Revenue Service with its tax return.

D. Results of the Tax Certificate Policy

The Commission's tax certificate policy has been instrumental in substantially increasing the number of broadcast licenses owned by minorities. Before 1978, minorities owned approximately .05 percent (40) of the approximately 8,500 total broadcast licenses issued by the FCC. A 1994 study performed by the National Telecommunications and Information Administration of the Department of Commerce indicates that as of September 1994, there were approximately 323 commercial radio and television stations owned by minorities, 2.9 percent of the total 11,128 licenses. The more than eight-fold increase in the number of broadcast licenses owned by minorities in the seventeen-year history of the Commission's tax certificate program underscores its importance and effectiveness in helping minorities overcome what the Commission identified in 1981 as the biggest obstacle to ownership—lack of access to capital . The following chart details current minority broadcast ownership levels by industry and by ethnicity.

Industry Total	Black	Hispanic	Asian	Native American	Minority Totals
AM Stations 4,929	101(2%)	76(1.5%)	1(0%)	2(0%)	180(3.7%)
FM Stations 5,044	71(1.4%)	35(.7%)	3(.1%)	3(.1%)	112(2.2%)
TV Stations 1,155	21(1.8%)	9(.8%)	1(.1%)	0(0%)	31(2.7%)
Cumulative Totals 11,128	193(1.7%)	120(1.1%)	5(0%)	5(0%)	323(2.9%)

Between 1943 and 1994, the Commission issued approximately 536 tax certificates; 419 were issued between 1978 and 1994. Approximately 359 of the total involved sales to minority-owned entities. Of these, 285 involved radio station sales, 43 involved television and low power television sales, and 31 involved cable television transactions.

Although FCC regulations require the buyer of a property for which a tax certificate is issued to hold that station for one year, the overwhelming majority of minority buyers retain their licenses for much longer. Of the 303 broadcast transactions in which tax certificates were granted between 1978 and 1993, the average holding period was approximately five years. We have not included 1994 tax certificate transactions in this figure because those licenses have been held for less than one year. In more than 100 cases in which minority tax certificates were granted, the station still is held by the original minority purchaser.

The great majority of the transactions in which tax certificates are awarded are relatively small, averaging a sale price of $3.8 million for radio. The 43 minority tax certificates transactions involving television station sales have a higher average sale price of $32 million. Data is not available for the 31 cable sales, although we know that cable transactions tend to be larger than broadcast transactions.

The Committee expressed an interest in use of the tax certificate program during the last five years. Between 1990 and 1994, the Commission issued 128 minority tax certificates: 17 for television sales, 91 for radio transactions and 20 for cable transactions. The following chart breaks down the activity in each service by year.

Year	TV	Radio	Cable	Total
1990	8	38	5	51
1991	3	19	1	23
1992	0	9	4	13
1993	4	13	4	21
1994	2	12	6	20
Totals	17	91	20	128

III. Conclusion

The minority tax certificate policy is the cornerstone of the Commission's policies to remedy the underrepresentation of minorities in the ownership of broadcast and cable television facilities. Many of the broadcast and cable television facilities acquired by minorities since 1978 were acquired with the benefit of the tax certificate policy. The tax certificate program has been remarkably effective in helping minorities surmount the greatest obstacle to ownership—attracting the necessary capital. Moreover, the tax certificate program is not a set aside or quota program. Rather, it is a minimally intrusive market-based incentive to remedy the underrepresentation of minorities in the ownership of broadcast and cable facilities. The program does not seem to have suffered from rampant abuse, such as a lack of real minority control of licenses or quick "flipping" of facilities.

At the same time, the Commission has been constrained in its ability to subject the program to a comprehensive reexamination. As with any program, this one could benefit from periodic review and improvement. If given the authority by Congress to undertake a reevaluation of the tax certificate policy, I am confident that the Commission could improve the administration and cost effectiveness of the minority tax certificate program.

This concludes my formal remarks. Once again, thank you for inviting the FCC to testify this morning. I would be happy to answer any of your questions.

Attachment.

AFFIRMATIVE OPPORTUNITY FOR THE COMMUNICATIONS REVOLUTION

BY WILLIAM E. KENNARD, GENERAL COUNSEL, FEDERAL COMMUNICATIONS COMMISSION

The communications, information and entertainment industries are vitally important, not only because they represent one-sixth of our economy, but because, more than any other industries, they reflect who we are as a nation, both here and around the world.

There should be Affirmative Opportunity for the Communications Revolution. Here are five precepts—Affirmative Opportunity Principles—to promote affirmative opportunity for the Communications Revolution.

ONE: AFFIRMATIVE OPPORTUNITY FOR ALL AMERICANS

All disadvantaged businesses deserve an opportunity to participate—small businesses owned by minorities and women and small businesses owned by nonminorities. Small businesses owned by minorities and women face unique obstacles which warrant unique opportunities. Benefits should be based on relative need.

TWO: THE THREE NOS: NO QUOTAS, NO GUARANTEES, AND NO TAKING FROM ONE TO GIVE TO ANOTHER

We do not establish quotas which award a certain number of FCC licenses or other benefits to a particular group. Nor do we guarantee success to any group. Affirmative Opportunity is about ensuring a fair opportunity to compete. Our rules should always ensure that the beneficiaries of our programs are committed to building businesses for the longterm, not flipping FCC licenses for a quick profit.

THREE: ONCE YOU GET A HAND-UP, YOU'RE ON YOUR OWN

Government benefits are a finite resource and should be distributed widely and as needed. Affirmative Opportunity means fair entry-level opportunities for businesses in their early growth phases. There should be limits on how many times a particular member of a disadvantaged group is permitted to invoke the aid of government.

FOUR: T-BASED INCENTIVES WORK BEST

Government should provide opportunities to compete. But the market must ultimately decide which competitor will win. This is the reason why we use techniques such as tax certificates, bidding credits, installment payments and auctions to provide tools for small and minority businesses to attract capital to compete.

FIVE: ONLY DO WHAT'S COST EFFECTIVE

We must continually test our programs under a rigorous cost-benefits analysis. The benefits should be proportional to the desired incentive; the program must be proportional to its costs.

Does the FCC's tax certificate program satisfy the Affirmative Opportunity Principles?

The FCC's tax certificate program is the cornerstone of the Commission's policies to remedy the underrepresentation of minorities in the ownership of broadcast and cable television facilities. It has been highly successful in helping minorities surmount the greatest obstacle to ownership—attracting the necessary capital. It is a not a quota or set aside. Rather, it is a minimally intrusive, market-based incentive which has worked.

There is compelling evidence that the program has produced meaningful results. Minority ownership has increased eight-fold since the FCC initiated the program. Most buyers who have benefitted from the program have been small minority businesses.

Nevertheless, as with any program, the tax certificate program could benefit from periodic review and improvement. Because of restrictions imposed by Congress, the Commission has been constrained in its ability to undertake a comprehensive reevaluation of the tax certificate program. If given authority by Congress to do so, the Commission can take steps to conform the policy to our Affirmative Opportunity Principles. The current debate about the tax certificate policy should not focus on a particular transaction or on issues of retroactive application of the tax laws. The debate should focus on how to improve the tax certificate policy.

1. The Commission can do more to ensure that minority entrepreneurs who participate in the tax certificate program are committed to building long-term businesses. To that end, the Commission could extend the holding period for licenses acquired through the benefit of the tax certificate. The current one-year holding period is too short. Although the average broadcast station acquired with the benefit of a tax certificate is held for five years, and many for much longer, formally extending the holding period would eliminate possibilities for abuse. Similarly, the Commission could limit the extent to which minority owners may sell, during the holding period, options, warrants, or other future interests in the company or in their equity in the company.
2. An Affirmative Opportunity Program distributes benefits as widely as possible. It seeks to create entry-level opportunities for businesses in their start-up phases. The Commission could impose limits on the number of times a particular member of a disadvantaged group may use the tax certificate program.
3. The tax deferral benefits must be proportional to the desired incentive and the program must be proportional to its costs. The Commission, in coordination with the Department of Treasury, could set limits on the amount of the tax deferral benefits in a given transaction. For very large transactions, the deferral benefits may be larger than necessary to create the desired incentive.

STATEMENT OF
LESLIE B. SAMUELS
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Chairman Packwood and Members of the Committee:

I am pleased to have this opportunity to present testimony today on behalf of the Department of Treasury concerning the Administration's position on the separate provisions of H.R. 831.

Permanent extension of 25 percent deduction for health insurance premiums paid by self-employed individuals.

Section 1 of H.R. 831 would extend permanently the deduction for health insurance costs of self-employed individuals. Under Internal Revenue Code (Code) section 162(l), certain sole proprietors, partners, and more than two-percent shareholders of Subchapter S corporations are permitted to deduct 25 percent of the amount paid during the year for insurance that constitutes medical care for the taxpayer and the taxpayer's spouse and dependents. The 25 percent deduction is not available, however, for taxable years beginning after December 31, 1993. Consequently, unless Congress acts, self-employed individuals will not be able to claim this deduction for health insurance premiums on their 1994 income tax returns.

As the members of this Committee know, the Administration proposed the extension of the 25 percent deduction, followed by an increase in the deduction to 100 percent of health insurance premiums, in the Administration's health reform bill of last year. We continue to believe that allowing a deduction for self-employed individuals more closely conforms their tax treatment to the treatment of other employers with employees. This treatment would recognize that these taxpayers share many attributes with both employers and employees. We also believe that the deduction for the self-employed will help to make health insurance more affordable for this segment of the population and will therefore contribute to expanded insurance coverage.

The Administration continues to support the permanent extension of the 25 percent deduction, and appreciates the opportunity to state for the record that this issue needs to be dealt with expeditiously. If Congress does not act before 1994 tax returns are filed, substantial administrative burdens could result for both taxpayers and the Internal Revenue Service (IRS).

The Treasury Department estimates that almost 3.2 million self-employed individuals would claim the 25 percent deduction on their 1994 tax returns if it were made available to them. Those tax returns are due on April 17, 1995. If the Congress fails to act to extend the 25 percent deduction prior to the due date for income tax returns, millions of taxpayers will be forced to decide whether to incur the costs of filing amended income tax returns. Any such amended returns -- including those that will have to be filed by farmers who filed their original 1994 returns prior to last week's March 1 special filing date -- will also impose additional administrative burdens and costs on both the IRS and State and local governments.

The Treasury Department has taken steps to make it easier for taxpayers to claim the deduction if timely Congressional action occurs on this matter. The 1994 Form 1040 includes a line for claiming the self-employed health deduction, with a caution that taxpayers cannot claim the deduction unless the law is changed. But only swift Congressional action can minimize taxpayer uncertainty, compliance costs, and administrative burdens.

Repeal of section 1071.

Section 2 of H.R. 831 would repeal Code section 1071 effective generally for sales and exchanges after January 16, 1995, and any previous sale or exchange if a tax certificate is issued by the Federal Communications Commission (FCC) after that date with respect to the transaction. Section 1071 of the Code generally allows a seller to postpone the recognition of gain realized on a sale or exchange of property if that sale or exchange is certified by the FCC to be "necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations." For example, it is our understanding that the FCC issues tax certificates to encourage licensees to free up frequencies for personal communication services. In addition, since 1978 the FCC has utilized its certification authority under section 1071 to promote minority ownership of communication properties.

The favorable treatment accorded by section 1071 allows the taxpayer to defer the tax on the gain realized in the transaction (although in certain circumstances such deferral may be indefinite). In this regard, the benefits of section 1071 are generally similar to the benefits accorded taxpayers who reinvest insurance proceeds following an involuntary conversion of property under section 1033 (e.g., as the result of fire or flood).

Regulations under section 1071 require that the taxpayer file an election with its return that includes the FCC tax certificate. This election requires the taxpayer to choose one of three alternative methods for taking advantage of the section 1071 deferral. The first approach is to apply a modified form of the involuntary conversion rules of section 1033. Generally, gain is not recognized to the extent that replacement property which is similar or related in service or use to the property sold is acquired before the end of the second full taxable year after the year in which the disposition occurs. The second approach in section 1071 is to reduce the depreciable bases of other assets held by the taxpayer at the time of the disposition and acquired before the end of the taxable year in which the disposition occurs. Unless the taxpayer requests an alternative allocation, the bases of all depreciable assets are reduced on a pro rata basis. The third approach is to elect a combination of the first two approaches (i.e., defer a portion of the gain through the acquisition of replacement property and another portion through reducing the bases of other depreciable property).

Congress delegated to the FCC the responsibility to determine when a transaction furthers FCC ownership and control policies. Thus, the IRS generally accepts as valid any FCC tax certificate that is issued, and it does not participate in or oversee the FCC's determination, or conduct an independent inquiry into whether, for example, minorities meaningfully participate in a purchasing group. The IRS's role is therefore generally limited to ensuring that the reinvestment and basis reduction requirements of section 1071 described above (including the rules of section 1033 which section 1071 incorporates by cross-reference) are satisfied by the seller.

The Administration opposes the outright repeal of section 1071.

The Administration is undertaking a comprehensive review of affirmative action programs, including certain aspects of section 1071. The purpose of this review is to analyze how effectively the government's resources are being targeted to address the areas of greatest need. In reviewing the operation of section 1071, we will consider possible modifications relating to ownership and holding period requirements as well as caps on the amount of gain eligible for deferral.

Modification of involuntary conversion rules.

Section 3 of H.R. 831 would make the deferral of gain provided by the involuntary conversion rules of Code section 1033 inapplicable where replacement property (including stock) is acquired from a related person. For purposes of this limitation, two or more persons would be treated as related if their relationships would result in a disallowance of losses under section 267 or section 707(b) of the Code. These changes would apply to replacement property acquired after February 5, 1995.

We do not oppose this change to section 1033, and would be willing to consider additional changes to ensure that gains deferred under that provision are not artificially eliminated through mechanical application of the basis rules when replacement property, for example, consists of stock rather than depreciable assets.

Phaseout of earned income tax credit for individuals having more than $2,500 of taxable interest and dividends.

Section 4 of H.R. 831 would deny the earned income tax credit (EITC) to individuals with interest and dividends includable in income in excess of $3,150. The amount of an otherwise available EITC would be reduced if the amount of interest and dividend income exceeded $2,500. The $2,500 threshold and $650 phase-out range would be indexed for inflation.

This provision, without the $650 phase-out range, was included in the President's FY 1996 budget. In developing that proposal, we gave consideration to a phase-out range as a way of minimizing marginal tax rates for affected taxpayers. Nevertheless, we decided against including a phase-out for two reasons. First, we are concerned about adding computational complexity to the EITC, that could result in inadvertent errors and other compliance difficulties. Second, we estimate that only about 2 percent of EITC claimants will be affected by this limitation, so that adverse marginal tax rate consequences will be narrowly confined. Nevertheless, we do not oppose a phase-out range like that contained in H.R. 831.

Mr. Chairman, this concludes my remarks. Thank you once again for affording me the opportunity to testify. I would be pleased to answer any questions that the Committee may have.

EXAMPLES OF INTERNAL REVENUE CODE PROVISIONS PURSUANT TO WHICH NON-IRS AGENCIES HAVE DISCRETION OVER TAX BENEFITS

- Sections 112 and 7508, pursuant to which the designation of an area by the President as a "combat zone" allows certain compensation to be excluded from income and extended periods of time to take time-sensitive actions (such as paying a tax liability or filing a return).

- Section 1033(h), pursuant to which liberalized rules for replacing destroyed residences and contents are available if the residence is converted as a result of a disaster which the President determines warrants assistance by the federal government under the Disaster Relief and Emergency Assistance Act.

- Section 169, pursuant to which pollution control facilities that are certified by State agencies, the Department of Interior, or the Department of Health and Human Services are eligible for special amortization rules.

- Section 42, pursuant to which State housing authorities make allocations of the low-income housing tax credit.

- Section 45A, pursuant to which employers are entitled to a credit with respect wages paid to certain individuals if they (or their spouses) are accepted for enrollment in Indian tribes.

- Sections 146 and 147, pursuant to which States are authorized to allocate the volume cap on private activity bonds and approve the issuance of such bonds.

- Section 1044, pursuant to which gain deferral is available on sales of publicly traded securities if the proceeds are invested in specialized small business investment companies (SSBICs) that, in turn, are licensed by the Small Business Administration (section 1202, which provides a 50-percent deduction for certain capital gains, also includes special rules applicable to investments in SSBICs).

- Section 1243, pursuant to which certain losses that would otherwise be capital losses are treated as ordinary losses if incurred in connection with small business investment companies licensed by the Small Business Administration.

- Section 1043, pursuant to which gain may be deferred in certain circumstances if, among other things, the President or the Director of the Office of Government Ethics, certifies that the divesture of the property is reasonably necessary to comply with certain federal rules.

- Section 1081, pursuant to which gain or loss is not recognized upon an exchange ordered by the Securities and Exchange Commission.

- Section 7518, pursuant to which tax benefits are available to certain owners of nautical vessels with whom the Department of Transportation or Commerce enter into an agreement regarding the establishment of a fund under the Merchant Marine Act of 1936.

- Section 1391, which authorized the Department of Housing and Urban Development and the Department of Agriculture to designate 104 federal empowerment zones and enterprise communities, pursuant to which businesses located in those areas would be eligible for specific tax incentives.

PREPARED STATEMENT OF FRANK WASHINGTON

I welcome this opportunity to appear here and present the facts related to my acquisition of the Viacom Cable Television Properties.

Before turning to the Viacom acquisition, let me briefly describe how I came to be here today. I was born in this city in a Jim Crowed Hospital ward in 1947. My father was a manual laborer and my mother a secretary.

I grew up in upstate New York. My father, who is buried in Arlington cemetery, died when I was twelve. My mother was left to support three children, of which I was the eldest.

Employing academic scholarships and a variety of summer and part-time jobs, I entered and graduated from, first, Cornell University and then, Yale Law School in 1974. I was and continue to be the only person in my extended family of birth to receive degrees at either the college or graduate level.

My first involvement with communications came in law school, where I wrote a note on cable television that was published in the Yale law Journal.

After practicing as a communications lawyer at Arnold & Porter here in Washington, I joined the Office of Telecommunications Policy in the Carter White House in 1977. My principal assignment was to explore ways to foster minority ownership of communications properties. At that time, less than one percent of broadcast stations were minority controlled. Government's focus was on increasing the diversity of voices without becoming directly involved in programming.

It was in this context that the use of the tax certificate to increase minority ownership was conceived. Section 1071, which had been law since the 40's, allowed for the FCC to find it in the public interest that qualified sellers receive a tax deferral—not an avoidance—for transferring a broadcast facility to minority buyers. It was then and still is a surgical and entirely voluntary mechanism for motivating the marketplace to include minorities in the broadcasting and cable television deal stream. It permits minorities to contribute something of value to a deal other than their operating skills and thus helps overcome the historic lack of access to capital which has been found to be the most important impediment to diverse ownership of media in the U.S. This mechanism was enthusiastically supported by the National Association of Broadcasters.

By 1978, I was a legal assistant to then FCC chairman, Charles Ferris, when the Commission enacted the tax certificate policy for radio and television stations.

In 1981, I left government, intending to acquire the experience necessary to become a businessman. I obtained a job as a vice president with Times Mirror's cable television division in Orange County, California. at Times Mirror, I was responsible for their videotext operations, now called multimedia.

A year after I left Washington, D.C., in 1982, the FCC, under Reagan appointee, Chairman Mark Fowler, extended the minority tax certificate policy to cable television.

In 1984, I was hired by McClatchy newspapers in Sacramento, California to manage their cable systems, with more than 100,000 subscribers, as well as their four radio stations, their cellular systems and their computer information services operations. I also served as a member of McClatchy's board of directors. Although the cash flow of those businesses was increased under my supervision, I recommended, and the board concurred, that McClatchy dispose of the properties for which I was responsible and concentrate on its newspaper operation.

After having direct P&L responsibility at McClatchy, I decided to become an entrepreneur and left McClatchy in 1987 with the single-minded purpose of buying cable television properties. It took over two years, the review of scores of deals, several short consulting projects, all of my personal savings and the proceeds from the sale of my home, and the help of the tax certificate program before I completed my first deal in 1990. Today, with the help of the minority tax certificate, I own and operate systems with 440,000 subscribers in Arizona, Georgia, Illinois, Iowa, Minnesota, Tennessee, South Carolina, and Wisconsin. I continue to own every cable system I ever purchased and operate them with a high level of commitment to my customers. Currently, we are in the midst of a $50 million rebuild throughout all the systems to dramatically increase channel capacity and improve customer service.

I acquired these systems with affiliates of intermedia partners, an investment partnership led by Leo J. Hindery, Jr. I first met Leo in early 1987, when he was the chief financial and development officer of the Chronicle Publishing Company, which owns substantial newspaper, cable television and television broadcast properties on the west coast. At that time, the chronicle and I considered acquiring cable systems serving communities in South Florida. Our bid wasn't accepted by the seller. One year later, Leo left the Chronicle and founded intermedia partners along

with limited partner investors which grew to include Chrysler pension, TCI, bank of New York, General Motors pension, bank of Hawaii and others.

Intermedia owns cable systems directly and in partnership with me. I have never encountered any difficulty in exercising complete control over the systems owned by Mitgo in partnership with Intermedia. I know from my personal experience that Leo and the entire Intermedia team are committed to complying fully with all of the requirements of the FCC'S minority control policies. Indeed, in many crucial respects, my partnership agreements with Intermedia go beyond the requirements.

As the chairman knows better than anyone else, recent changes in both technology and telecommunications policy have made it apparent that the cable television industry will soon encounter significant competition from well-capitalized local exchange telephone companies, including, most formidably, the Bell operating companies. As a consequence, I have concluded that geographical consolidation as well as the overall growth of our cable holdings is imperative for my business. Only in this fashion can I match my opponents' economies of scale and other forms of marketplace efficiencies. You only have to scan the Wall Street journal to know that this market concentration effort is underway industry-wide, involving deals at least as large as Viacom. Notably, virtually all of the significant transactions in the past year have been structured on a non-taxable basis using other sections of the tax code.

Knowing that Viacom operated cable systems serving slightly more than one million subscribers in areas of the country where I and/or Intermedia already had cable systems, I approached Intermedia and discussed the possibility of our purchasing Viacom's cable operations. We decided to pursue the opportunity, and the negotiation of the Viacom acquisition began in earnest in July of 1994. Negotiations proceeded throughout the Autumn of 1994 and were effectively concluded in late December. The price is around $2061 per subscriber, which is consistent with the $2046 per subscriber average price of the eight other largest cable deals announced since June 1994.

On January 20, 1995, RCS Pacific, L.P. ("RCS Pacific") entered into a definitive asset purchase agreement with Viacom International Inc. ("Viacom") to purchase Viacom's cable television systems in California, Ohio, Oregon, Tennessee, and Washington. RCS Pacific is a limited partnership with two partners, Mitgo and Intermedia partners. Mitgo will own and is responsible for funding 21% of the equity of RCS Pacific and is the managing general partner. Intermedia partners will own 79% of RCS Pacific and be the limited partner. I own 100% of Mitgo and will have control over personnel, programming, pricing, franchises, capital expenditures, financings and all other significant decisions.

On February 6, Congressman Bill Archer, Chairman of the House Ways & Means Committee, introduced H.R. 831 which, among other things, would repeal Section 1071 effective retroactively to January 17, 1995. This was long after the Viacom cable transaction was initiated, long after the parties had settled on the significant contract terms and even after the minority tax certificate application had been filed at the FCC. It is important to note that the national press began to report on an agreement in principle in this transaction in early august 1994. In early January 1995—before the Ways and Means Committee announcement—the Wall Street Journal and Washington Post, among other publications, were actively reporting that the deal was effectively agreed to.

I am not questioning at all the propriety of congressional review of the tax certificate policy. It is never inappropriate to review an existing policy. However, the singling out of my deal for retroactive application of Congressman Archer's legislation and the haste with which it was introduced and passed in the House troubles and befuddles me. Indeed, I am shocked that the first piece of tax legislation passed by the new House of Representatives was a retroactive tax increase that was targeted to stop a single transaction. I am particularly troubled because I have so scrupulously observed both the letter and the spirit of the law in every cable acquisition in which I have been involved.

The fundamental wrong implicit in this one aspect of the House-Passed bill strikes me as being of great importance. Not only does it fly in the face of simple fairness to the involved parties, who will have relied to their great detriment on existing law, but it also establishes the extremely unfortunate and unsettling precedent of killing legitimate deals through retroactive application of tax legislation.

No one familiar with the speed of the legislative developments in the House surrounding the review of Section 1071 in general and as it relates to the Viacom cable transaction can deny that the clear intention of the Ways and Means Committee in including the January 17, 1995 effective date in this bill was to kill my transaction. Frankly, I am surprised—and dismayed—that the U.S. House of Representatives would target one particular transaction, without one shred of evidence being

offered by anyone that my transaction in any way violates the statutory program designed to encourage it.

To repeat the basic chronology, by the date of the January 17, 1995 press release, my transaction already had been under negotiation for seven months, it had been approved by intermedia partners and by our banks, it had been ratified twice by Viacom's board of directors, it had been covered extensively in the trade and general press and it had consumed millions of dollars in expenditures by the parties, including fees paid for financing commitments from our banks. Significantly, each of these events occurred in 1994, well prior to the effective date contained in the legislation. This committee should note that these and similar negotiation milestones has served, on equitable principles, as the basis for transition relief in major tax legislation approved by the tax-writing committees in recent years.

Furthermore, if the tax certificate is retroactively repealed, as reflected in the House bill, there will simply be no Viacom acquisition and therefore no tax revenue. The U.S. Treasury will be no better off as a result of this bill. Moreover, my effort to build my business to an efficient size, long in planning and after months spent in expensive negotiations, will be shattered. Meanwhile, I and the other parties to this deal will have expended and lost millions of dollars in transaction costs.

There is a great overlooked irony here: I could have decided, like so many others recently, to cash in my chips and just leave the cable television business. Accomplishing this purchase requires me to assume a mountain of debt. Upon closing the purchase, I will face bruising competition from the telephone companies and others. The easy way out would have been to avoid the work, risk and financial liabilities I am assuming. It would have been the easy way out—but I didn't take that way when I went to college and law school or worked as a lawyer in one of this city's finest law firms or went into government or changed careers from law to business or spent everything I had to become a cable entrepreneur. And I do not want to do it now.

In 1947, the year I was born, Jackie Robinson became the first black man to play major league baseball. Jackie Robinson has often served as a model for my life. His examples by deed and determination have not only advanced the case of black Americans, but also that of americans as a whole. All I am asking is that the rules of this game not be changed as I am going through the stadium gate for my chance to compete in the big leagues.

I would be pleased to answer any questions the committee may have. thank you.

Attachment.

FRANK WASHINGTON
601 UNIVERSITY AVE., SUITE 211
SACRAMENTO, CA 95825

(916) 921-2290
FAX (916) 921-2085

March 9, 1995

The Honorable Frank Murkowski
United States Senate
SH-706 Hart Senate Office Building
Washington, D.C. 20510-0202

Dear Senator Murkowski:

This letter is in response to your request at the March 7, 1995 Senate Finance Committee hearing for additional information. You inquired about the relationship of Tele-Communications, Inc. ("TCI") to the Viacom cable transaction and about the percentage of the overall cable market which TCI currently serves.

As you know, I am the 100% owner of Mitgo Corp., which is the 100% general partner of RCS Pacific, L.P. ("RCS"), the purchaser of the Viacom cable systems. InterMedia Partners IV, L.P. ("InterMedia") is the 79% limited partner in RCS, and TCI holds a 25% limited partnership interest in InterMedia. In other words, TCI's indirect interest in RCS is less than 20%; TCI is only one of several limited partners of the limited partner of RCS. Neither InterMedia nor any of its several limited partners, including TCI, will control or have any management role in the operations of RCS. As I noted in my testimony, I have over 12 years of cable and telecommunications senior management experience, and I will have control over programming, pricing, franchises, capital expenditures and financings.

The actual purchase price of the Viacom systems will be subject to various closing adjustments, which is the industry practice. However, we estimate that the price will be approximately $2.3 billion. The financing structure contemplates that RCS will receive approximate-

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The Honorable Frank Murkowski
March 9, 1995
Page 2

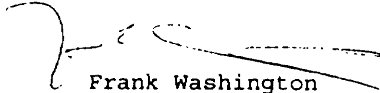
ly $1.6 billion directly from banks as senior debt and approximately $600 million as subordinated loans, which may be provided by TCI. The remainder of the funding, or approximately $100 million, will be provided as equity.

As I stated in my testimony, I will provide 21% of whatever equity is required to meet the purchase price. If, as we now expect, $100 million of equity is needed, I will be required to put in $21 million in cash. Under those circumstances, I expect to provide at least $2.1 million from personal funds and will borrow from third parties the balance. Whatever equity is required, I must, under the agreement, put up 21% of that equity.

Finally, you also inquired as to the percentage of the overall cable industry that TCI's cable systems currently serve. According to the recent industry statistics, TCI's cable systems, including those of its partially owned affiliates, serve subscribers representing approximately 20% of the industry's approximately 60 million subscribers.

Should you have any questions, or need additional information, please feel free to contact me.

Sincerely,



Frank Washington

COMMUNICATIONS

STATEMENT OF AMERICAN WOMEN IN RADIO AND TELEVISION, INC.

American Women in Radio and Television, Inc. ("AWRT") hereby submits this statement to the Senate Finance Committee to express AWRT's strong support for the use of tax certificates by the FCC to increase minority ownership of broadcast and other mass media properties. AWRT also encourages the Committee to preserve the authority of the FCC to extend the availability of tax certificates to sales of mass media properties to women. AWRT is a non-profit, national organization of professional women and men who work in radio, television, cable, advertising—essentially the electronic media—and closely allied fields. The mission of AWRT is to enhance the impact of women in the electronic media and allied fields by educating, advocating, and acting as a resource to its members and the industry.

AWRT strongly supports appropriate policies to promote the ownership of broadcast and other communications properties by women and minorities. AWRT believes that the FCC's award of tax certificates pursuant to Section 1071 to increase minority ownership of broadcast and cable properties is an example of just such an appropriate market-based policy. Consistent with the underlying intent of Section 1071, tax certificates have proven to be a valuable incentive that furthers the FCC's policy of increasing ownership of broadcast stations and cable properties by qualified minorities. AWRT also supports the extension of the FCC's tax certificate policy to include the availability of Section 1071 certificates to investors in qualified women-owned companies seeking to acquire broadcast and cable properties and to companies that sell their existing broadcast and cable properties to qualified women-owned companies. Significantly, last year the FCC made tax certificates available to promote investment in women-owned companies bidding for Personal Communications Service licenses—a critical step to ensuring that women have an opportunity to participate in the communications revolution. This legislation threatens that opportunity.

Since adoption of the FCC's policy to award tax certificates to increase minority ownership of broadcast properties in 1978, tax certificates have proven to be one of the most valuable financial incentives in broadcast acquisitions. As of October 1994, 283 tax certificates have been awarded by the FCC for broadcast stations while 25 have been issued for cable sales. Tax certificates are a pivotal factor in evaluating a broadcast sale or investment.

To ensure the appropriate use of Section 1071 certificates, AWRT supports rigorous review by the FCC of the eligibility of companies for tax certificates. Stringent case-by-case review of the ownership and qualifications of a company on which an application for a tax certificate is based can be conducted by the FCC to weed out any potential abuses of the FCC's tax certificate policy. The general, unsubstantiated fear of such abuses should not be used as a basis to eliminate an appropriate and effective market-based incentive for increasing minority ownership of broadcast stations and an incentive that could be appropriately used to increase ownership of broadcast stations and other mass media facilities by women.

Past studies have shown that the use of tax certificates has directly buttressed the FCC's important goal of increasing minority ownership of broadcast and cable facilities. Tax certificates have the added value of stimulating investment in mass media properties and minority-owned companies. By requiring the recipient of a tax certificate to reinvest the sale proceeds in "qualified replacement property," the awarding of Section 1071 tax certificates stimulates economic growth. Specifically, Section 1071's requirement of reinvesting the proceeds of the tax certificate in "qualified replacement property" to defer taxation fuels additional investment by the seller. This investment, rather than the mere pocketing of the sale proceeds, stimulates additional economic growth in the form of economic expansion, additional job growth and the creation of new and greater market opportunities. Tax revenues also

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are derived even if the investor who receives a tax certificate elects to reinvest the proceeds of the tax certificates in other existing media properties rather than new properties because the investment in the existing property will trigger a taxable sale of that existing property.

The tax revenues gained from the multiplier effect of this additional investment and the continued operation of the broadcast and cable properties by minority-owned companies may well offset the revenue losses from deferral of taxation permitted by the award of a Section 1071 tax certificate. In addition, award of a Section 1071 certificate merely permits deferral of the tax. The tax ultimately will be realized upon the sale of the replacement property.

Tax certificates also provide a direct market-based incentive for investment in minority-owned companies. Initial investors in minority-owned companies are eligible for a Section 1071 certificate on the sale of their interests. Market-based incentives that increase access to capital are essential to redressing the under-representation of minorities and women in the broadcast industry. Statistics on women-owned businesses demonstrate the continued barriers that women face in raising the capital required to acquire broadcast and cable properties. The discrimination that exists against women entrepreneurs has been recognized by Congress. Seven years ago, due in large part to the leadership of women in Congress, Congress enacted the Women's Business Ownership Act of 1988. In 1992, Congress again sought to redress the hurdles that women and minorities face in raising capital by enacting the Small Business Credit and Business Opportunity Enhancement Act of 1992. Congress' recognition of the barriers faced by women in obtaining financing for business ventures as well as statistics on the low level of representation of women in ownership of broadcast stations fully support extension of the FCC's policy of awarding Section 1071 tax certificates to qualified women-owned companies seeking to acquire broadcast and cable facilities and to provide incentives for women-ownership of broadcast and cable properties.

Thirty-two percent (32%) of all small businesses were owned by women in 1991 according to the U.S. Small Business Administration.[1] Despite these encouraging general statistics, this business growth has not been mirrored or even suggested in the broadcast industry. In 1987, the latest year for which relevant statistics currently are available, only 26 television stations were owned and controlled by women out of 1,342 television stations operating in the United States.[2] In other words, in 1987 only 1.9% of all television stations were owned and controlled by women. Out of the 10,244 radio stations operating in the United States at that time, only 394, or 3.8% of all radio stations, were owned 50% or more by women.[3] Thus, in 1987, only 420 out of a total of 11,586 broadcast stations were owned and controlled by women.

Other studies confirm the low level of representation of women in the ownership ranks of broadcast facilities. A Congressional Research Service Study entitled "Minority Broadcast Station Ownership and Broadcast Programming: Is There a Nexus?," released in 1988, found that women held a 51% or greater ownership interest in 7.1% of the broadcast stations surveyed. A study commissioned by the FCC in 1982 found that women held 50% or more of the stock of the licensees of 8.5% of the AM stations, 9% of the FM stations and 2.8% of the television stations across the country. Although the 1982 study and the 1988 Congressional Research Service study are not directly comparable because they use different definitions of control (50% and 51%), the comparison is still useful. The rough comparison reveals that women controlled 7.9% of stations in 1982 and only 7.1% in 1988—if not a decline, then certainly a stagnation, in the number of women-owned broadcast stations.

These numbers obviously are at odds with the number of women in the United States and in the U.S. workforce. According to the 1990 U.S. Census, women represented 46% of the civilian labor force in the United States. The FCC's latest employment statistics also indicate that women and minorities continue to be employed in the broadcasting industry at levels significantly below their representation in the overall workforce. In 1993, women constituted only 39.6% of the broadcast workforce, with 32.8% at the professional managerial level. In the cable industry, total employment of women decreased from 41.7% to 41.6, 30.9% of the professional/managerial jobs in the cable industry are held by women.[4]

[1] *See Women Business Owners*, Congressional Caucus on Women's Issues (1992).

[2] See Women Owned Business, U.S. Department of Commerce (1990) (based on 1987 economic census); see also 1988 Broadcasting/Cablecasting Yearbook, p. A-2. More recent statistics on women-owned businesses are expected to be released by the Bureau of the Census in June 1995.

[3] Id.

[4] *FCC Equal Employment Opportunity Trend Report* (June 22, 1994).

These statistics demonstrate what Congress clearly recognized when it enacted the Omnibus Budget Reconciliation Act of 1993 and authorized the FCC to use spectrum auctions to award licenses for commercial mobile radio services—that the dissemination of spectrum licenses among a wide variety of applicants, including businesses owned by women, is an important and legitimate government interest. The same Congressional concern about under-representation by women in the provision of spectrum-based services that resulted in that Congressional mandate warrants the use of Section 1071 tax certificates as an incentive to increase female ownership of broadcast and cable facilities. Accordingly, in the context of any modifications made to Section 1071, the FCC should retain the discretion to extend tax certificates to sales of mass media facilities to women.

Finally, AWRT has encouraged the FCC to conduct a survey and study on the current level of women ownership of broadcast facilities. A study on female ownership of broadcast licenses has not been undertaken since the FCC's study in the 1980s. Such a study would enable the FCC and Congress to identify trends in broadcast ownership and provide an important foundation for future policy decisions.

AWRT looks forward to continuing to work with the Senate on issues of importance to women in the communications industry.

STATEMENT OF CABLESOUTH, INC.

(SUBMITTED BY DAVID SILVERMAN, COLE RAYWID & BRAVERMAN, L.L.P)

CableSouth, Inc., by its attorneys, hereby submits these Comments in connection with the Committee's consideration of H.R. 831 which proposes to repeal the tax certificate program administered by the Federal Communications Commission ("FCC"). CableSouth, which is located in Birmingham, Alabama, owns and operates nine cable television systems in 29 different communities serving a total of approximately 30,000 subscribers located in and around Albertville and Tuscaloosa, Alabama. Thus, by most standards, CableSouth is a relatively small cable television company.

On October 10, 1994, CableSouth entered into an Asset Purchase Agreement to sell its cable systems to a qualified minority purchaser, and filed its tax certificate request at the FCC on January 13, 1995. Between October 10 and January 13, the parties sought and obtained local franchise approval from 10 different local franchising authorities and obtained Hart-Scott-Rodino approval, the application for which cost approximately $45,000. Indeed, CableSouth has spent approximately $200,000 on fees and expenses on the sale of its cable systems to date. CableSouth has contracted to sell its systems to Charter Communications III, L.P., a company that is controlled by Kelvin R. Westbrook, an African-American. Mr. Westbrook previously qualified for a tax certificate from the FCC on April 26, 1994, which allowed his company, Charter Communications, L.P., to acquire cable TV systems serving communities in Alabama, Georgia, Louisiana .and Mississippi. That transaction closed on April 29, 1994, and Mr. Westbrook has owned and operated these systems since then. The Asset Purchase Agreement negotiated between CableSouth and Charter Communications III would allow Mr. Westbrook to acquire CableSouth's cable systems in Alabama. Without the tax certificate, there may be no transaction.

Regardless of the Committee's recommendation regarding the tax certificate program generally, CableSouth respectfully requests the Committee to reconsider at least one aspect of the retroactivity provision of H.R. 831. Specifically, Section 2(e)(2)(A) of the bill exempts transactions that were "binding" on January 16, 1995, if the FCC tax certificate has been applied for or issued by that date. Paragraph (B) of that section defines a "binding" contract as one which is not contingent on the issuance of an FCC tax certificate. Thus, CableSouth's proposed transaction would not be subject to the retroactive reach of H.R. 831, but for the fact that the Asset Purchase Agreement is contingent upon receipt of the requested tax certificate. It is difficult to imagine that any request for a tax certificate pending at the FCC is not being sought pursuant to an agreement that is contingent upon receipt of that tax certificate. Accordingly, as currently written, H.R. 831 has the unintended effect of adversely affecting every request pending at the FCC on January 17, 1995.

If the Committee were to amend the language of Section 2(c)(2) to exempt all tax certificate requests pending at the FCC on or before January 16, 1995, the Committee could reduce the hardship caused by this legislation on those few parties who had negotiated complex transactions in good faith reliance on the existence of the FCC's tax certificate policy, without affecting the bill's application to the Viacom

transaction.[1] Including CableSouth's request, there are only five tax certificate requests concerning proposed cable television transactions pending at the FCC filed prior to January 16, 1995. There are three such requests concerning radio station transactions, and six concerning proposed TV station transactions. Thus, the requested change in H.R. 831 would have minimal impact on the ultimate purpose of the proposed legislation.

Sales transactions for media properties such as CableSouth's systems involve a long and expensive process. It is unfair to retroactively impose the requirements of this bill on a transaction that was negotiated, executed and for which all governmental approvals, including the tax certificate request had been obtained or filed for prior to the first public announcement on January 17, 1995 that Congress would be considering this legislation.

The economic analysis prepared for the Committee by the Joint Committee on Taxation dated March 6, 1995 demonstrates the economic value of a tax certificate.[2] Indeed, although the parties may not agree on the precise amount by which the sales price of the CableSouth systems was lowered due to the parties' expected receipt of the FCC tax certificate, both parties are in full agreement that the systems would have to be sold for a higher price without the tax certificate. Whether the parties would be able to agree on a purchase price for the systems exclusive of a tax certificate is doubtful at best. Furthermore, even if a new price could be agreed upon, Mr. Westbrook might not be able to raise the additional funds required to complete the purchase. Accordingly, Mr. Westbrook's ownership and operation of these systems may well be contingent upon receipt of the requested tax certificate.

In summary, so long as H.R. 831 exempts any request for an FCC tax certificate filed on or before January 16, 1995, the bill will serve the drafters' purpose without adversely affecting transactions negotiated prior to the bill's introduction, and that were not intended to be included within the bill's retroactive grasp.

STATEMENT OF WILLIE D. DAVIS

I am offering this testimony in support of the Federal Communications Commission's minority tax certificate policy pursuant to Section 1071 of the Internal Revenue Code. Others have explained how the FCC implements the policy and have defended its legality. I want to explain from my own experience how the policy has worked in practice, and the benefits that it has provided to minority broadcasters like myself.

I am an African-American, and I have been a radio broadcaster since 1977 when I acquired my first radio station. Today, my company, All Pro Broadcasting, Inc., owns five radio stations. I have an ownership interest in a sixth radio station, and I am in the process of acquiring an interest in two major-market television stations.

Five of All Pro's acquisitions have involved tax certificates issued under Section 1071 of the Internal Revenue Code. I therefore understand the program as well as anyone and can testify first-hand about its benefits and limitations.

I did not begin my career as a broadcaster, but as a professional football player. I graduated from Grambling State University in Louisiana in 1956, at a time when much of America was still officially segregated. I then played professional football for twelve years, two with the Cleveland Browns and ten with the Green Bay Packers. I enjoyed considerable success as a football player: I captained the Packers in Super Bowls I and II, and I was inducted into the Professional Football Hall of Fame in 1981. Despite my success, however, I did not retire from football a wealthy man; I played before the days of free agency.

I pursued a graduate education, receiving a masters in business administration from the University of Chicago in 1968. After retiring from football, I purchased and operated a beverage distributorship which served a portion of the Los Angeles area.

In 1976, I became aware of a small radio station in Inglewood, California, which was in bankruptcy. This was before FM radio became more successful than AM. I purchased the station, KACE–FM, in 1977, for $225,000; the station was off the air when I purchased it, and I had to invest approximately another $600,000 to put it back into operation. All Pro still owns the station today, although I am in the process of selling it. My first acquisition did not involve a tax certificate. The FCC had not yet extended its tax certificate policy to acquisitions by minority-controlled com-

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[1] Viacom filed its request for a tax certificate at the FCC on February 3, 1995.

[2] Joint Committee on Taxation *Background and Issues Relating to: (1) The application of Code Section 1071 under the Federal Communications's Commission's Tax Certificate Program; (2) Involuntary Conversions under Code Section 1033, and (3) The Earned Income Tax Credit at 13-15 (JCX-8-95), Much 6, 1995.*

panies, and, in any event, a tax certificate would not have been meaningful to a seller out of bankruptcy.

In contrast, I would not have been able to make my next acquisition, which was of stations WAWA AM/FM (now WMCS/WLUM–FM), Milwaukee, without the tax certificate program. Others have testified how the tax certificate program assists minority purchasers to gain access to capital, and it has certainly assisted me in this way as well: in fact, I believe I was the very first radio station buyer to benefit from it. Just as importantly, the tax certificate program has given sellers an interest in pursuing transactions with me.

Most radio and television sales are privately negotiated, either directly between principals or through media brokers, with as little publicity as possible. No radio station owner or broker would have had reason to seek me out as a possible buyer without the minority tax certificate program. I found out about the availability of KACE in Inglewood only because it was auctioned out of bankruptcy and I lived and worked in the area. In the case of the Milwaukee stations, which I purchased in 1979, there was in fact another interested buyer who had almost reached an agreement with the owner before I contacted her. At first, she did not want to deal with me, but after we explained the tax certificate policy, she became very interested and ultimately we reached an agreement. I paid $1,250,000 for the stations in 1979, and I still own them today.

My next acquisitions were in 1982 and 1984. I purchased an AM station in Houston, KYOK, for $1,500,000, and an AM station in Burien-Seattle, KQIN (now KGNW) for $750,000. Although both were very small transactions, the availability of the tax certificate program made them possible. As I learned, however, it is extremely difficult to operate a stand-alone AM radio station today, given the dominance of FM. After upgrading KQIN from a 500 watt daytime-only station to a powerful fulltime operation, I sold it in 1986 for $2,770,000. I sold KYOK in 1988 for $2,450,000 to a company that also owned an FM station in Houston. In both cases, All Pro paid taxes on the sales.

In 1988, I used the proceeds from these sales to buy KYOU–FM (now KZDG) in Greeley (Denver), Colorado, for $5,500,000 in a tax certificated transaction. My experience in Denver demonstrates that the tax certificate program is no guarantee of success; I sold the station in 1993 for $3,500,000, a $2,000,000 loss. (The station sold again this year for $5,500,000, so the U.S. Treasury has made up for my loss.)

Finally, in 1992, I purchased KCKC(AM) and KBON–FM (now KCXX) in San Bernardino, California, for $5,000,000, using the tax certificate program.

All Pro still owns five of the eight stations that it has purchased during the last eighteen years, although I am in the process of selling KACE-FM, Inglewood, my first acquisition, which did not involve a tax certificate. Like any businessman, some of my acquisitions have been successful; some have not. The tax certificate program only gave me a foot in the door; it did not guarantee success.

The FCC's minority tax certificate program is not a "set aside" or an affirmative action program. Sellers of broadcast stations are under no compulsion to sell to members of minority groups, and the FCC does not penalize sellers in any way for not doing so. In fact, Section 310(d) of the Communications Act prohibits the FCC from considering whether the sale to any person other than an applicant would better serve the public interest. Thus, the tax certificate program is the only means that the FCC has to encourage sellers of broadcast stations to consider sales to members of minority groups, and without tax certificates, I feel certain that I would never have even been given an opportunity to bid on some of the stations that All Pro has purchased.

I firmly believe that minority broadcasters who utilize the tax certificate program have an obligation to return something to the community, and that even while free to respond to marketplace demands and to determine how best to meet the needs of their communities, they are more sensitive to minority audiences. In All Pro's case, this means that three of our five stations have utilized program formats directly targeted towards minorities. KACE in Inglewood, WMCS in Milwaukee and KCXX in San Bernardino have all broadcast a so-called "urban" format, targeting African-Americans. (KCKC in San Bernardino has a news format, and WLUM–FM in Milwaukee has an "alternative rock" format.) Previously, All Pro simulcast KACE and KCXX (then KABE). In contemplation of the sale of KACE, the formats have been changed.

As a minority-owned company, All Pro also actively seeks out minorities for management positions, where they can act as role models and mentors for other minorities. I myself have been very much involved on a daily basis in the operation of the stations since 1988, when I sold the beverage company and decided to expand the radio business. I travel between Los Angeles and Milwaukee stations, maintaining a residence in both communities. I currently serve as general manager of the

Inglewood station. (Until we announced the pending sale, the general manager was a minority woman.) In Milwaukee, two of the four top managers are minority. In San Bernardino, one of the two top managers are minority. In my view, minority-owned companies benefiting from the tax certificate program have an obligation to take a leadership role in recruiting and employing minorities in key management positions.

I am also personally active in the communities that All Pro's radio stations serve, I serve on the Board of Trustees of the University of Chicago (my alma mater), Marquette University in Milwaukee and Occidental College in Los Angeles, and have served a host of civic and philanthropic organizations, including the 1984 Olympic Committee, the Greater Los Angeles Visitors Bureau, Los Angeles Explorers (Boy Scouts of America), Southern California Businessman's Association, Los Angeles County Special Task Force, Los Angeles Festival in Black, Bicentennial Black Achievement Exhibit and Foundation for People. I was also appointed by President Reagan to the President's Commission on Executive Exchange. I have received the Byron "Whizzer" White Award (awarded to athletes for outstanding service to country, community and team), the NAACP's Man of the year Award in 1978, and the West Coast Father's Council Father of the Year Award in 1990. I served three years on the Board of Directors of the National Association of Broadcasters.

I am particularly interested in retention of the tax certificate program, because I am now in the process of branching out into the ownership of television stations. I am using proceeds from the sale of KACE–FM to acquire an interest in Qwest Broadcasting L.L.C., which has contracted to buy television stations WATL in Atlanta and WNOL in New Orleans, both cities where the majority of the population is minority. Through Qwest, I intend to continue my commitment of service to the minority community.

STATEMENT OF TOM L. JOHNSON

My name is Tom L. Johnson. To my knowledge, I am the Nation's only Native American controlling and operating a commercial television broadcast station—KTEN-TV, Ada, Oklahoma. Minority Tax Certificates have played a vital role in my achieving this status, and I believe my story makes evident the public and social benefits Congress hoped to achieve through this program. I further believe that it would be a mistake to terminate the Tax Certificate program, although I do recognize the validity of Congress imposing certain safeguards on the use of Tax Certificates as discussed below.

I first learned that my Native American ancestry was a valuable asset when I sought to enter the broadcasting industry in 1979. This was just a year after the FCC began to issue tax certificates pursuant to Section 1071 of the Internal Revenue Code to promote minority ownership in broadcasting. At this time, I was one of three applicants seeking a UHF construction permit for a small Texas market. I was able to negotiate a settlement with the other applicants for some cash and small interests in my company. But with the Texas oil bust, decline in real estate values and 21% interest rates, I was unable to construct. I subsequently sold this construction permit.

This temporary set back was short lived. I next sought a Low Power television license in Paris, Texas. And, relying on my minority status, I was awarded a construction permit for K08KK in late 1983.

In 1984, I formed Channel 10 Limited Partnership and immediately purchased control of KTEN-TV in Ada. With the benefit of the tax certificate policy allowing investors to defer capital gains, I was able to recruit a number of local businessmen as limited partners. In March, 1985, I consummated the acquisition of KTEN upon the FCC's historic issuance of tax certificate number 182—the first ever issued to a Native American television broadcaster.

I served as KTEN's President and General Manager and was able to dramatically improve the station's ratings, revenue, and cash flow over the next few years. It was at this time that I had the vision of cable companies becoming strategic partners with broadcasters surfaced. While many broadcasters were treating the cable television industry as staunch enemies, I entered into an agreement with a major MSO to become its exclusive advertising sales representative. Utilizing my advertising sales and ad insertion expertise for this CATV partnership, I formed one of the first Television/CATV alliances in the country. If a minority tax certificate had not facilitated my entry into broadcasting, it is doubtful I would have had the opportunity to promote these industry-model alliances.

I thereafter participated in another limited partnership which constructed Station KETK to service the Jacksonville, Tyler, Marshall, Texas television market; KETK became an NBC affiliate.

In the late 80's "seller's market," I received a lucrative, unsolicited offer to purchase my interests. Regrettably, out of deference to my fiduciary and financial obligations to my partners, I sold all broadcast and cable interests; my investor-partners were able to defer their tax "gain" under the FCC's tax certificate program for providing start-up capital for a minority broadcaster.

But, the new purchasers of KTEN-TV failed to achieve a sufficient cash flow to service the acquisition debt. The station therefore became insolvent and was placed into bankruptcy.

In 1994, again using a Tax Certificate to attract "seed money," I succeeded in acquiring the station's assets from bankruptcy. Already I have turned the station around financially and made it one of the few triple network affiliates in the country (ABC, NBC and Fox).

I presently have my eye on certain telecommunications properties such as telephone companies and cellular operations. Through First American Communications Enterprises (FACE), a corporation I formed and control, I asked the FCC for a declaratory ruling in 1992 that the statutory language of Section 1071, as interpreted by the FCC was broad enough to encompass telephone operations—operations which in the information age can "broadcast" voice messages to a universe of subscribers.

Today Congress is considering repeal of the Tax Certificate program, thereby chilling my future prospects as well as those of other minority broadcasters; and, importantly, minorities seeking to become personal communications service designated entity-licensees.

I believe that my story and how minority Tax Certificates were used by me is a powerful example of the difference the Tax Certificate program can make; powerful enough to warrant Congress taking a long and hard look as to whether repeal of this law is in the long-term national interest. Nevertheless, I fully understand Congress' desire to take measures to stop any abuses of this program if there are any or any appearance of abuses. In this regard, I believe that a $50 million cap as proposed by some legislators would provide sufficient incentives under the minority tax certificate program and at the same time come to grips with Congress' concerns about abuse. Similarly, I believe a requirement that recipients of Tax Certificates hold their property for a reasonable period of time, for example five years, before any benefit accrues, is also a reasonable safeguard.

In conclusion, I appreciate the Senate Finance Committee making a matter of public record my written testimony. I urge that the Tax Certificate program has worked well in the past, and insofar as I am personally concerned, the program has been vital.

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March 7, 1995

Hand Delivery

Honorable Robert Packwood
Chairman, Committee on Finance
United States Senate, Rm SD-215
Dirksen Senate Office Building
Washington, D.C. 20515

Re: Hearing on the Administration of the Tax Certificate Program, Internal Revenue Code Section 1071

Dear Mr. Packwood:

We respectfully submit this written statement for the printed record of the March 7, 1995 hearing by the Committee on Finance on the administration of Section 1071 of the Internal Revenue Code of 1986, as amended ("Code"). In accordance with your instructions, six (6) copies are enclosed.

In view of the numerous comments received by the Committee in connection with the hearing, we have not provided an overview of Code Section 1071.[1] Instead, we have assumed familiarity with the Code Section and will respond directly to the inquiries raised.

[1] For an excellent discussion of the mechanics of Code Section 1071, please see, Edward L. Glazer and Stephen D. Fisher, *Section 1071: FCC-Certified Transactions Involving Minority-Controlled Entities*, 47 Tax Law. 91 (1993).

THE FCC'S 1978 POLICY IS CONSISTENT WITH THE UNDERLYING INTENT OF CODE SECTION 1071

The 1978 Policy

On May 25, 1978, the Federal Communications Commission ("FCC") issued its *Statement of Policy on Minority Ownership of Broadcasting Facilities.* 68 F.C.C.2d 979 (1978) (hereinafter cited as the "*1978 Policy Statement*"). The expressed policy was "to increase significantly minority ownership of broadcast facilities." The ultimate goal of this policy was to increase programming diversity so that it more accurately reflected the viewpoints of all Americans. Ownership was preferred as a means of furthering program diversity because it does not require direct governmental intrusion into programming. This policy was consistent with several court decisions,[2] and its ideals are part of the 1934 Communications Act and inherent in the First Amendment.[3]

One of several steps the FCC selected to implement this policy was the use of its authority to grant tax certificates under Code Section 1071 in circumstances the FCC determined appropriate. *1978 Policy Statement.* Appropriate circumstances include those where a sale of media is proposed to parties with a significant minority ownership interest and where there is a substantial likelihood that diversity of programming will be increased.

The policy of using Code Section 1071 to enhance opportunities in the broadcasting industry was expanded to cable television systems in recognition of the technological revolution occurring in the communications and broadcast industries. In December 1982, in a *Policy Statement on Minority Ownership of Cable Television Facilities*, the FCC stated a new policy:

> "Believing that minority ownership of cable television systems is a significant additional means of fostering the inclusion of minority views in programming, and noting the relative scarcity of minority owned cable systems presently operating, the [Federal Communications] Commission adopts a policy of encouraging minority ownership of cable systems, utilizing the Commission's tax certificate authority as a form of subsidization of minority entrepreneurs seeking to enter the cable television market." 52 Rad. Reg. 2d (P & F) 1469 (1982).

The FCC acknowledged that "[T]he functions that cable television system operators perform for their subscribers are, to a large degree, similar to those performed by broadcast licensees for their respective audiences." Id. at 1470. The FCC also recognized that greater efforts were necessary

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[2] *See, Citizens Communications Center v. F.C.C.*, 447 F.2d 1201 (D.C. Cir. 1971); *TV 9 Inc. v F.C.C.*, 495 F.2d 929 (D.C. Cir. 1973).

[3] In the Communications Act of 1934, Congress assigned to the FCC exclusive authority to grant licenses, based on "public convenience, interest, or necessity," to persons wishing to construct and operate radio and television broadcast stations. 47 U.S.C. §§ 151, 301, 303, 307, 309 (1982 ed.).

to achieve the goal of diversified programming contemplated by the Communications Act of 1934, and stated, "despite our previous efforts to ensure program diversity, it appears that additional measures in the area of cable television are appropriate." Id. at 1471.

In September 1985, the FCC expanded the application of Code Section 1071 to include non-wireline cellular transfers. The FCC explained:

> "although cellular systems do not constitute "radio broadcasting stations" within the meaning of the [Communications] Act [of 1934], a broad reading of the language of the tax statute (Section 1071 of the Internal Revenue Code) is appropriate in light of the general congressional intent underlying the statute's passage and radical transformation of the telecommunication marketplace since the statute's adoption." *In re Telocator Network of America*, 58 Rad. Reg. 2d (P & F) 1443, 1448 (1986).

In responding to the technological innovations occurring in communications and broadcasting industries, the FCC held:

> "In light of the legislative intent of Section 1071, the dramatic changes in telecommunication marketplace since its original enactment and Commission precedent, we conclude that the phrase "radio broadcasting station" is illustrative of the more general congressional intent to facilitate the effectuation of the Commission's policies rather than restrictive, and the scope of the phrase is properly construed as expanding with the extension of the Commission's pro-competitive policies. Accordingly, we hold that the phrase does not bar the issuance of tax certificates in connection with transfers of non-wire cellular partnership interests in cellular markets 31 through 90." Id. at 1450.

Thus, in fulfilling its role in a rapidly evolving industry, the FCC would have been remiss if it had failed to allow its application of Code Section 1071 to evolve in a commensurate manner into the new telecommunications technologies.

Intent of Code Section 1071

Code Section 1071 was originally enacted in 1944 as Section 112(m) of the Internal Revenue Code of 1939 ("1939 Code"). Act of February 25, 1944, Ch. 63, Section 123(a), 58 Sta 40-43, 46. In Code Section 112(m), as originally enacted, Congress delegated to the FCC the authority to grant tax certificates as:

> " . . . necessary or appropriate to effectuate the policies of the Commission with respect to the ownership and control of radio broadcasting stations . . ." 1939 Code Section 112(m).

This section was passed to help the FCC implement a "new policy" that prohibited ownership of more than one radio station in a single market. Senate Finance Committee Report, 78th Cong., 1st Sess., S. Rept. 627 (1943). Congress intended it to provide relief for licensees who had to

sell or exchange such stations as a condition of obtaining license renewal. Id. Congress did not specify any limits to this delegation of authority. Thereafter, the FCC exercised its broad regulatory authority to make and change policies concerning the ownership and control of broadcasting stations with the aid of tax certification.

Section 112(m) was recodified without material change as Section 1071 in the Internal Revenue Code of 1954. H. Rep. No. 1337, 83rd Cong., 2nd Sess., reprinted at 1954 U.S. Code Cong. & Ad. News 4621, 59072. However, the Senate Report accompanying the bill did specifically comment on the definition of "radio broadcasting":

> "The form of 'radio broadcasting' as used in the Bill and in the 1939 Code has an established meaning in the industry and in the administration of the Federal Communications Act which is sufficiently comprehensive to include telecasting." S. Rep. No. 1622, 83rd Cong., 2nd Sess., reprinted at 1954 U.S. Code Cong. & Ad. News 4261, 5072.

Clarifying language, in the form of a technical amendment, was substituted into Section 1071 in 1958. This amendment provided that tax certificates would be granted as "necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy, by the Commission." Technical Amendments Act of 1958, Pub. L. No. 85-866, § 48, 72 Stat. 1606, 1642 (1958); H.R. Rep. No. 775, 85th Cong., 1st Sess. 29 (1957). This change facilitated the FCC's usage of Section 1071 to implement evolving policies, such as that to increase the diversity of broadcast licensees.

Consistency between 1978 Policy Statement and Code Section 1071

The intent underlying Code Section 1071, namely, to provide the FCC with a tool to effectuate its policies, is entirely consistent with the 1978 Policy Statement. Indeed, Code Section 1071 remains an essential tool at the disposal of the FCC in its attempts to increase minority ownership of broadcast facilities. It is difficult to conceive of many industries that have changed as significantly as the communications industry has over the last fifty years. The FCC would have been remiss if it had not expanded the scope of the tax certificate program to keep pace with the rapid developments in the communications industry.

Recently, attention has been focused on the size of the tax benefits expected to be granted under the tax certificate program. Certainly, it is quite difficult to quantify the social benefit derived from the tax certificate program in any meaningful way. To attempt to assess this benefit against a hypothetical tax cost is pointless. The magnitude of the transactions now being undertaken in the deployment of the National Information Infrastructure, however, are indicative of the importance of the communications industry in our society today. Now, more than ever, it is essential that the tax certificate program be endorsed to ensure universal access to telecom facilities. Code Section 1071 indisputably remains an essential tool in diversifying the ownership of broadcast licenses.

THE FCC'S ADMINISTRATION OF CODE SECTION 1071 DOES NOT CONSTITUTE AN IMPERMISSIBLE EXERCISE OF LEGISLATIVE AUTHORITY

The FCC's administration of Code Section 1071 constitutes a permissible exercise of legislative authority. This has been examined by academics, the courts and by Congress on more than one occasion. In each case, the conclusion reached is that it is a legitimate exercise of legislative authority.

Court Decisions

Prior to the 1978 policy, the Review Board, in an opinion accepted by the FCC, had taken the view that the "Communications Act, like the Constitution, is color blind." *Mid-Florida Television Corp.*, 33 F.C.C 2d 1, 17 (Rev. Bd.), *aff'd*, 37 F.C.C.2d 559. The issue of what the FCC should consider in awarding broadcasting licenses arose in *TV 9, Inc. v. FCC*, 495 F.2d 929 (D.C. Cir. 1973), *cert. denied*, 419 U.S. 986 (1974). In *TV 9*, the FCC, in awarding a license, gave little weight to the fact that the losing applicant was minority-owned. In considering the reasoning of the FCC, the appeals court stated:

> "To say that the Communications Act, like the Constitution, is color blind, does not fully describe the breadth of the public interest criterion embodied in the [Communications] Act. Color blindness in the protection of the rights of individuals under the law does not foreclose consideration of stock ownership by members of a Black minority where the [Federal Communications] Commission is comparing qualifications of applicants for broadcasting rights . . ." *Id.* at 936.

Similarly, the same court, in *West Michigan Broadcasting Co. v. FCC*, 735 F.2d 601 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1027 (1985), considered a situation in which two companies filed mutually exclusive applications to build a new FM radio station in Michigan. One of the companies was owned by a minority who would fully participate in the station's management. In that case, the appeals court held that the FCC could give merit to a minority applicant regardless of whether there was a substantial minority-group population in the city where the license was located. *Id.* at 609. Further, increased media ownership by minorities, the court decided, should conclusively be presumed to advance the public interest. *Id.*

More recently, the Supreme Court upheld the constitutionality of two policies that enhance the opportunities for minorities to acquire FCC licenses. *Metro Broadcasting, Inc. v. F.C.C.*, 110 S. Ct. 2997 (1990). In evaluating two related FCC policies to increase minority ownership, the Supreme Court consolidated *Metro* with *Astroline Communications Company Limited Partnerships et al. v. Shurberg Broadcasting of Hartford, Inc. et al.* The policies in question were 1) the FCC program of awarding enhancement for minority ownership in comparative proceedings for new licenses; and 2) the distress sale program permitting a limited category of existing radio and television stations to be transferred only to minority-controlled firms.

In finding both FCC policies constitutional, the Supreme Court held that minority ownership programs had been specifically approved and mandated by the Congress, and as such required judicial deference. *Id.* at 3008. Additionally, FCC minority ownership policies promote programming diversity. *Id.* at 3009, 3010. Further, programming diversity serves important First Amendment values, and remains consistent with the 1934 Communications Act. *Id.* at 3010, 3012.

Congressional Action

As part of Section 115 of the Communications Amendments Act of 1982, Congress authorized the FCC to choose by lottery among competing qualified applicants for certain licenses as an alternative to lengthy comparative proceedings. Pub. L. No. 97-259, § 115, 96 Stat. 1087, 1094-95 (codified at 47 U.S.C. § 309(i) (1982). Nevertheless, Congress required that:

> "significant preferences will be granted to applicants or groups of applicants, the grant to which of the license or permit would increase the diversification of ownership of the media of mass communications. To further diversify the ownership of the media of mass communications, an additional significant preference shall be granted to any applicant controlled by a member or members of a minority group." *Id.*

The legislative history of this provision acknowledges the FCC's continuing minority ownership policy and diversity of viewpoint rationale, and clearly shows that Congress intended to ensure that a similar minority preference was applied in any random selection licensing system. H. Conf. Rep. No. 765, 97th Cong., 2d Sess., 40, reprinted in 1982 U.S. Code Cong. & Admin. News 2261, 2284.

Since 1987, using appropriations legislation, Congress has prohibited the FCC from using any of its appropriated funds to repeal, retroactively apply changes in, or to reexamine any of its race or gender preference programs. Act of Dec. 22, 1987, Pub. L. No. 100-202, 101 Stat. 1329. This prohibition applies to the tax certificate, distress sale, and comparative licensing programs, respectively. *Id.* The limitation did not prevent an expansion of the programs. Thus, Congress has answered the statutory authority question by effectively ratifying the Commission's interpretation of the public interest standard and adopting a legal presumption that minority ownership produces more diverse programming that better serves the public interest.[4]

There can be no question that the FCC's administration of Code Section 1071 is a permissible exercise of legislative authority. Notwithstanding the judicial decisions and Congressional action, it is disturbing that questions are now being raised by the Committee on Finance about the legislative authority to administer a Code section that has been in force and effect for more than fifty years.

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[4] In Comment, *FCC Tax Certificates For Minority Ownership of Broadcast Facilities: A Critical Re-examination of Policy*, 138 U. Pa. L. Rev. 979 (1990), the author correctly concludes that the FCC's administration of the program is within its statutory authority. *Id.* at 999.

THE TAX INCENTIVE PROVIDED IN CODE SECTION 1071 IN FACT FOSTERS MINORITY OWNERSHIP OF BROADCAST FACILITIES

In our experience as counsel to clients engaged in the broadcasting and communications industry, we emphatically affirm that the tax certificate program has provided opportunities for minority individuals to participate in the broadcasting and communications industries. Moreover, it has served to spark investment in the entire telecommunications industry. In examining the effectiveness of the program, it is noteworthy that the National Telecommunications and Information Administration reported that minorities held .5% of broadcast licenses in 1978, and as of 1994 held 2.9% of them. See, National Telecommunications and Information Administration, United States Department of Commerce, *Analysis and Compilation Minority-Owned Commercial Broadcast Stations*, 1994. Also, the FCC has reported that 378 tax certificates were issued for broadcast stations and cable television facilities from 1978 to 1994.

THE FCC POLICY IS A NECESSARY OR APPROPRIATE MEANS OF ACHIEVING THIS GOAL

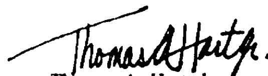
The 1978 Policy remains as important today as it was in 1978, if not more so. While there have been significant improvements in minority ownership of broadcasting facilities and greater diversity in programming over the past sixteen years, there is still a long way to go. *See, Metro, supra at 3003-05.* The tax certificate program is one of several effective measures in achieving the FCC's policy objectives and as such should not be repealed or replaced.

The tax certificate policy permits more broadcast and cable properties to reach their highest valued use, thereby creating jobs and generating investment and tax revenues. The policy's reinvestment feature retains capital in the media industries, where it helps build the nation's growing communications infrastructure. Furthermore, the policy helps small businesses enter the competitive marketplace and ultimately become large taxpayers themselves.

The FCC, working closely with the IRS, possesses the expertise to review and improve upon the tax certificate policy. The FCC is obtaining public comment on the policy, with comments due on April 17, 1995. Among the matters the FCC might consider are the need for additional data on the policy's long and short range tax consequences, the optimal holding period for facilities obtained under the policy, and procedures for additional scrutiny of the bonafides of tax certificate applicants. Congress should defer additional action on this matter until it receives the FCC's report and order.

We thank you for your consideration. If we can be of any further assistance, please do not hesitate to contact me.

Respectfully submitted,



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STATEMENT OF THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL

The Minority Media and Telecommunications Council ("MMTC"), a nonprofit association which supports efforts to increase minority ownership and participation in broadcasting and other communications businesses, is pleased to submit its written statement in support of the FCC's tax certificate policy.

The policy provides substantial benefits to the public and taxpayers alike. By involving otherwise excluded minorities in media ownership, more broadcast and cable properties reach their highest valued use, thereby creating jobs and generating investment and tax revenues. The policy's reinvestment feature retains capital in media industries, where it helps to build the communications infrastructure. Furthermore, the policy helps minority businesses succeed and ultimately become taxpayers.

The underlying purpose of the policy is to provide access to capital to minorities who have traditionally been unable to secure sufficient funding to purchase broadcast and other media facilities. This goal cannot be overstated. Past racial discrimination still distorts the marketplace. From an economic standpoint, minority media and telecommunications entrepreneurs remain severely undercapitalized. Thus, retention of the policy assures some level of minority participation in the communications industry.

Nor is the policy in any sense unfair to taxpayers. First, the policy provides a tax deferral rather than a tax exemption. Thus, the federal government still enjoys the benefits of receiving taxes on the transaction, and of indirectly receiving taxes from the new minority-owned business. Second, the federal government expends few resources to administer this program. Finally, because the policy directly addresses access to capital and is neither a quota or set-aside, it does not disadvantage whites.

The tax incentives flow equitably to both parties in a transaction because the allocation of the tax benefit between the seller and the minority purchaser will be the subject of intense negotiations. The tax benefit can be expected to be allocated in large part to the purchaser since, absent a qualified minority purchaser, there will be no tax benefit.

Before adopting the program, the FCC pursued its obligation of ensuring diversity in broadcasting by adopting equal employment opportunity rules as well as ascertainment rules, which required broadcasters to present programming in response to community interests. In 1978, the FCC noted that "while the broadcasting industry has on the whole responded positively to its ascertainment obligations and has made significant strides in its employment practices, we are compelled to observe that the views of racial minorities continue to be inadequately represented in the broadcast media." Statement of Polity of Minority Ownership of Broadcasting Facilities, 68 FCC2d 979, 983 (1978) (hereinafter "1978 Policy Statement"). The FCC concluded that additional measures such as encouraging the ownership of broadcast facilities by minorities were necessary to assure diversity of programming. Accordingly, the FCC decided to make use of its authority to grant tax certificates to transferors where such transfers advanced the policy of increasing minority ownership.

The 1978 Policy Statement was based on recommendations offered by a task force on minority ownership (the "Task Force") sponsored by the FCC in 1977 under the leadership of Richard Wiley, who chaired the FCC during the Nixon and Ford Administrations. The Task Force report thoroughly documented the need for minorities to participate in the broadcasting industry as owners, and the need for marketplace intervention to help achieve that objective. Federal Communications Commission's Minority Ownership Task Force, Minority Ownership Report (1978).

The Task Force concluded that minorities are underrepresented among broadcast station owners in significant part because barriers confronted minorities at each of the three principal points of entry into commercial broadcasting: (i) challenging a license renewal—except for cases in which there has been gross misconduct, incumbent owners have the advantage of an expectation of license renewal in any proceeding in which their license renewal is challenged; (ii) acquiring an unused frequency—as there are few unused frequencies available in communities of substantial size, acquisition of a commercially viable unused frequency is difficult; (iii) purchasing an existing facility—in addition to the major obstacle of securing financing, determining which stations are for sale is another significant barrier, as this information is not always publicly available. In response to these findings, the FCC implemented the tax certificate policy as a means of addressing the financing problem and encouraging incumbent broadcasters with properties for sale to seek out minority buyers.

The record created by the Task Force was supplemented in 1982 by a report from an advisory committee (the "Advisory Committee") headed by former Commissioner Henry Rivera, who now chairs MMTC. Final Report of the Advisory Committee on

Alternative Financing for Minority Opportunities in Telecommunications to the Federal Communications Commission (May, 1982). The recommendations issued by the Advisory Committee culminated in a Policy Statement issued under Chairman Mark Fowler. Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC2d 859 (1982) ("1982 Policy Statement").

In the 1982 Policy Statement, the FCC adopted a capitalizing feature for tax certificates which encouraged investment in minority-controlled broadcasting entities by allowing certain shareholders in such entities to become eligible for tax certificates upon divestiture of their interests. Adoption of the new feature was supported by the Advisory Committee's demonstration that such a feature was permissible and consistent with the intent of Section 1071, noting that the policy was unintrusive and highly cost effective.

Congress has thoroughly overseen the FCC's implementation of the Policy. Since 1988, the FCC appropriations legislation has expressly acknowledged the existence of the tax certificate policy and has expressly forbidden use of appropriated funds to repeal or retroactively change longstanding rules to promote the ownership of broadcasting licenses by minority group members and women. "The language in this year's appropriations bill simply preserves long-standing policies of both the Congress and the FCC, policies that have been upheld by the courts, and policies that benefit all Americans." 134 Cong. Rec. S10004, *S10021 (daily ed. July 27, 1988). At the same time, Congress has clearly stated that these restrictions are "intended to prevent the Commission from backtracking on its policies that provide incentives for minority participation in broadcasting" but that they do "not prohibit the agency from taking steps to create greater opportunities for minority ownership." H. Conf. Rep. No. 103-708, 103d Cong. 2d Sess. 40 (1994).

In addition, the FCC objectives to increase minority participation in broadcasting have received continued support from the Supreme Court. In *NAACP* v. *FPC,* 425 U.S. 662, 670 n. 7 (1976), the Court observed:

> The Federal Communications Commission has adopted regulations dealing with the employment practices of its regulatees . . . .These regulations can be justified as necessary to enable the FCC to satisfy its obligation under the Communications Act of 1934 . . . to ensure that its licensees' programming fairly reflects the tastes and viewpoints of minority groups.

More recently, Congress encouraged the FCC's use of its tax certificate authority to assure entry of minorities in the provision of spectrum-based services. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, Title VI, §6002(b), 107 Stat. 312, 392 (1993).

The policy has a direct effect on increased minority ownership, which in turn serves the governmental objective of promoting broadcast diversity, an objective which is consistent with the Supreme Court's acknowledgement that "broadcasting may be regulated in light of the rights of the viewing and listening audience, and that the widest possible dissemination of information from diverse and antagonistic sources is essential to the public welfare." *Metro Broadcasting, Inc.* v. *FCC, 497 U.S. 547, 579-84 (1990) (citing Associated Press* v. *U.S.,* 326 U.S. 1, 20 (1945)). The extensive research cited in *Metro* demonstrates that minority ownership promotes diversity and service to the public, especially in content-based programming. See, e.g., Congressional Research Service, "Minority Broadcast Station Ownership and Broadcast Programming: Is There a Nexus?" (1988). Data collected by the FCC from nearly 9,000 of its over 12,000 television and radio stations indicated that there is a strong correlation between minority ownership and programming targeted to minority audiences. While only 20% of stations without any Black ownership responded that they provide programming directed to Black audiences, 65% of stations with Black ownership said that they did so. Only 10% of stations without Hispanic ownership responded that they provided Hispanic programming, while 59% of stations with Hispanic owners did so.

The Congressional Research Service study was consistent with the results of four other studies, each cited in *Metro,* addressing the same question. "Johnson, Media Images of Boston's Black Community" (Jan. 28, 1987) (available at the William Monroe Trotter Institute, University of Massachusetts at Boston) (unpublished manuscript) (examining treatment of over 3,000 local news stories by white and Black-owned media and finding statistically significant differences in racial identifications and positive or negative treatment of certain types of stories); Fife, "The Impact of Minority Ownership on Broadcast News Content: A Multi-Market Study" (1986) (available at the Department of Telecommunications, Michigan State University) (unpublished study) (concluding that minority owned television stations had statistically significantly higher representation of Blacks on newscasts than did comparable non-minority owned stations); Jeter, "A Comparative Analysis of the Programming Practices of Black-Owned, Black-Oriented Radio Stations and White-

Owned, Black-Oriented Radio Stations," Ph.D. Dissertation, University of Wisconsin, 1981 (finding that Black-owned radio stations had statistically significantly more diverse play lists, featuring jazz, rock, blues, gospel formats, e.g., than did white-owned, Black-oriented stations); Honig, "Relationships among EEO, Program Service, and Minority Ownership in Broadcast Regulation," in Proceedings of the Tenth Annual Telecommunications Policy Research Conference 85, 87-88 (1983) (finding, for example, that in Black oriented stations, 72% of management employees at Black owned stations were Black but 38% of management employees at White owned stations were Black).

Of course, it would be stereotyping to suggest that all minorities should only target their programming towards their respective groups, or that all minorities would even desire to do so. However, the evidence clearly shows that minority broadcasters do make special efforts to serve those members of their own racial groups.

The policy is especially valuable to the cable industry. Cable operators possess unique power to select the range of programming available to viewers and to stimulate diversity in the national programming marketplace. Thus, diversity in cable ownership is especially critical to cable viewers. The most notable evidence of this is Robert Johnson's Black Entertainment Television, which is geared primarily toward the African American community but widely viewed by persons of all races. Therefore, any weakening of the policy will severely undermine the FCC's reliance on its minority ownership policies as a substitute for content-based regulation in promoting First Amendment values.

There have been few, if any abuses of the policy. One indication of this is that properties obtained with tax certificates are typically retained. According to the FCC's Office of Communications Business Opportunities, the average retention rates of broadcast properties attained through tax certificates is approximately five years. The minority owner/operators who testified at the House and Senate hearings on this issue documented the retention of their stations, as well as their outstanding community service made possible by the tax certificate policy.

Nonetheless, third parties have an ample opportunity to challenge the bonafides of a tax certificate applicant through the FCC's petition to deny process. Indeed, abuses of the policy have been very rare.

The policy's incentive to sell properties to minorities is only a moderate one, having been primarily responsible for increasing minority broadcast ownership from zero to 2.7 percent in 15 years (between 1978 and 1993). This figure is very significant, but not indicative of a massive rush by sellers to trade with minority buyers; indeed minority-owned properties collectively represent only about 0.5% of industry asset value.

Therefore, the policy should be applied to transactions regardless of size, since the policy was designed to help minorities enter the mainstream of American commerce. It is not unusual, given the growth in the communications industry, for a tax certificate to be used for an occasional large transaction. Since white companies have such a long headstart in spectrum access and media ownership, no minority broadcaster or cable system owner is even close to possessing sufficient size and influence to justify "graduation" out of the program.

Recently, MMTC became aware that the Finance Committee is considering a concept by which the percentage of gain which can be deferred would decreases as the size of the deal increases. This is entirely logical. The tax certificate policy has the practical effect of countering the "old boy" network under which brokers (there are 150, none a minority) typically represent sellers and find buyers they consider "qualified." Minorities are seldom high on most brokers' call lists.

A broker's work typically involves a fixed benefit component—putting the parties together to do the deal. That part of a broker's work is essentially independent of the size of the deal.

A broker's work also involves a variable benefit component—mediating the parties' discussions of the terms of the deal. That work consumes time and effort in rough proportion to the size of the deal.

The broker is compensated with a fixed retainer independent of the size of the deal, and he or she also received a variable sum calculated by a sliding scale with decreasing percentages of each fixed increment in size above a minimum. That compensation structure is conceptually similar to the sliding tax deferral structure the Committee is considering.

The tax certificate has the practical effect of counterbalancing the "old boy" network manifested by the unregulated station brokerage business. Like a broker's work, the tax certificate policy has fixed and variable components. The fixed component involves creating the opportunity for a minority to do the deal. Its value is essentially independent of the size of the deal. The variable component involves en-

dowing the minority with bargaining leverage in negotiating the terms of the deal. The value of the variable component is proportional to the size of the deal.

Thus, the tax certificate policy operates essentially as a mirror of the brokerage business. If the policy were structured to provide a sliding scale of deferred taxation, paralleling the fee structure applicable to brokers, it would be precisely narrowly and appropriately tailored to address the purpose for which it was created.

The FCC has initiated a rulemaking proceeding in which it can investigate the policy's (1) long and short range tax consequences, (2) need for an optimal holding period for facilities obtained under the policy, and (3) procedures for additional scrutiny of the bona fides of a tax certificate applicant. Congress should receive the FCC's report before considering major modifications to the policy. Furthermore, MMTC urges the Committee not to apply any changes retroactively. Not only is retroactive tax policy presumptively unlawful, see *Bowen* v. *Georgetown Univ. Hosp.*, 488 U.S. 204 (1988), it is anti-business and unfair.

MMTC conducts basic research on a range of issues relating to minorities and the media. Presently, we are close to completing a comparative study of the retention rates of radio stations bought through the tax certificate policy and similarly situated stations bought about the same time without the policy. MMTC will be pleased to share its findings with the Committee, and to be available to assist the Committee in further reviewing the tax certificate policy.

The National Association of Broadcasters ("NAB")[1] is pleased to express its support for the "minority tax certificate" policy of the Federal Communications Commission ("FCC" or "Commission") This provision, found in Section 1071 of the Internal Revenue Code, is designed to promote minority participation in broadcast station ownership; it generally has been effective in doing so

The policy itself establishes an incentive for the sale of a broadcast property (or cable) to a minority controlled entity. Further, if the seller fails to reinvest the amount of the capital gains tax within two years, the treasury recovers the entire amount. The policy, therefore, represents a deferral of capital gains -- not a complete forgiveness. Additionally, if the gains realized are reinvested, then the economy of our country is strengthened. In either case, it is a classic "win-win" policy

Prior to the implementation of the tax certificate in 1978, minorities owned one half of one percent of broadcast properties. Today, minorities own close to three percent of broadcast stations While ownership of broadcast properties by minorities is still low, the number of licenses issued to minority controlled businesses would be far less without this program . Tax certificates have been issued for over 300 broadcast transactions throughout the country -- in large, medium, and small media markets. A number of these properties are still held by the minority purchaser. Significantly, many of the minority companies such as Granite Broadcasting, Spanish Broadcasting System, and Blackstar Communications have flourished as a direct result of the policy Additionally, while FCC regulations require the purchaser of a property for which a tax certificate is issued to hold the station for one year, the average holding period is closer to five years for broadcast properties.

NAB has supported this policy from the very start On September 2, 1977, NAB filed a Petition for Declaratory Ruling at the FCC, urging the agency to issue a tax certificate (under Section 1071 of the U.S. Tax Code) to any broadcaster who sells his or her broadcast property to a minority buyer NAB pointed out that, under this NAB-sponsored proposal, the tax certificate would enable the seller to avoid capital gains taxes if the proceeds from the sale were invested in a "similar property" within a specified time period. The FCC adopted the NAB tax certificate proposal on May 17, 1978, stating that this policy would further the Commission's overall policy of advancing minority ownership of broadcast facilities.

It should be noted that during 1977 -- the same year as NAB's petition calling for the creation of the minority tax certificate -- the NAB Board of Directors created the "Broadcast Capital Investment Fund," known as "Broadcap." Broadcap, designed as a Minority Enterprise Small Business Investment Company ("MESBIC") has provided -- for nearly twenty years -- equity funding, guarantees and low-cost loans to minority entrepreneurs. It too has contributed to the overall levels of minority broadcast ownership.

[1] NAB is a nonprofit, incorporated association of radio and television stations and networks which serves and represents the American broadcast industry

In recent years, NAB has urged the Commission to expand the tax certificate policy, through modifications that would enhance parties' eligibility to use these mechanisms. It is our view that this policy has produced a beneficial increase in the level of minority ownership of broadcast facilities. Similarly, NAB supports efforts that would refine the policy to make it more effective in providing otherwise unavailable ownership opportunities for minority broadcast entrepreneurs.

The minority tax certificate policy has enjoyed broad bipartisan support. It has been endorsed by Republican and Democratic Commissions. The policy has been overseen and endorsed by the Congress. In 1986, when questions were raised about other programs designed to promote minority ownership under the jurisdiction of the FCC, the tax certificate policy remained in effect. While there may be concern over possible abuses, the FCC is well equipped to deal with that eventuality. Specifically, any license transfer is open to public scrutiny and the FCC's petition-to-deny process affords any party the opportunity to raise questions and issues at the time the transaction is being examined. In addition, the Commission retains the authority to go back and review the transaction if there is a sufficient reason to do so. In fact, the Commission has, in the past, denied the use of the tax certificate in transactions which did not fit the eligibility requirements.

Indeed, this position of advancing minority ownership in broadcasting was discussed and reaffirmed by the NAB Board of Directors at its meeting of January 16-18, 1995. Thus, we urge the Congress and the FCC to continue its favor of the minority tax certificate concept.

The policy has been effective in promoting entrepreneurial opportunities and addresses the critical problem many potential minority purchasers have confronted -- access to capital. It is not a large, cumbersome, or invasive bureaucratic enterprise, yet it does provide a helpful boost to traditional business practices. It is a voluntary federal policy designed to further a worthy policy objective. Many minority broadcasters will attest that, but for this policy, they would not own a broadcast station today. The tax certificate policy represents an opportunity to "close the deal" when competing against other buyers for the purchase of a broadcast property. While the minority buyer still must obtain the necessary capital, the availability of the tax certificate often provides the extra incentive to sell to a minority purchaser.

Minority ownership promotes a diversity of services available to the public.[2] As the Congress and the communications industry move to the development of the "information superhighway," the ability to deliver a wide and diverse set of services to all customers will be increasingly important. As broadcasters, we feel we are uniquely positioned to compete with telephone companies and cable systems by delivering many of the same services through our assigned spectrum. The promotion of minority ownership and the resultant diversity of services can only serve to strengthen the competitive edge among all of those who will deliver services to the consuming public.

NAB wants to thank the Committee for the opportunity to include this statement in the record. We would be pleased to answer any questions that the Committee has regarding this issue. We look forward to working with you toward a successful resolution to this matter.

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[2] This was confirmed in research cited in Metro Broadcasting, Inc. v. FCC, 497 U.S. 547, 579-84 (1990).

NAMIC

NATIONAL ASSOCIATION OF MINORITIES IN CABLE

BOARD OF DIRECTORS

President

Immediate Past President

Vice President

Secretary

Treasurer

Members

March 14, 1995

Honorable Robert Packwood, Chairman
Committee on Finance
United States Senate
SD-215 Dirksen Senate Office Building
Washington, DC 20510

RE: Hearing on the Administration of the Minority Tax Certificate Program Internal Revenue Code 1071

Dear Senator Packwood:

The National Association of Minorities in Cable (NAMIC), respectfully submits this statement for inclusion in the printed record of March 7, 1995 hearing, held by the Committee on Finance, concerning the administration of Section 1071 of the Internal Revenue Code of 1986, the Minority Tax Certificate Program.

NAMIC was founded to promote diversity in all aspects within the telecommunications industry, provide leadership to ensure broad participation from diverse communities, facilitate diversity management education and increase the status and achievement of its members. Our membership includes representatives from cable and related telecommunications industries.

NAMIC strongly supports efforts to increase equity participation by minorities and women in existing and emerging communications technologies. We also believe that any modifications to the minority tax incentive program should not include a cap on the amount of gain eligible for tax deferral. Given the increasing consolidation in the cable industry, minority entrepreneurs need the ability to participate in large scale system acquisitions. Any cap would unfairly work against such participation. Similarly, proposals to modify the program by eliminating the provision that permits sellers to defer tax on gains will foreclose most opportunities for minorities to become owners of media properties. Unless existing media owners have incentives to sell to minority companies, they will have little incentive to provide access to minority and women-owned firms. Minority ownership is also critical to

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increasing the availability and dissemination of diverse programming and viewpoints.

In summary, NAMIC urges the Senate to maintain and enforce the existing Internal Revenue Code Section 1071, which has served as a cornerstone to remedy the under-representation of women and minorities in the telecommunications industry.

Respectfully submitted,

Andrew L. Dixon

Andrew L. Dixon
President
National Association of Minorities in Cable
P.O. Box 4197
Cerritos, CA 90703

Testimony of

Larry Irving

Assistant Secretary for Communications and Information

National Telecommunications and Information Administration

The Clinton Adminstration

On behalf of the Administration, The National Telecommunications and Information Administration (NTIA) appreciates the opportunity to submit testimony regarding the March 7, 1995 bearing on Section 1071 of the Internal Revenue Code and the Federal Communications Commission's (FCC) application of the tax certificate policy. As stated in the Treasury Department's testimony of March 7, the Administration opposes outright repeal of Section 1071. The Administration is undertaking a comprehensive review of affirmative action programs. As a part of that review, the Administration will analyze the tax certificate program in greater detail. In light of recent criticism of the program, however, the Adminstration would note there is evidence supporting continuation of the program that must be considered along with any evidence supporting termination.

Section 1071 provides certain tax relief to the seller of property if the sale or exchange is certified by the FCC "to be necessary or appropriate to effectuate a change in policy of, or the adoption of a new policy by the FCC with respect to the ownership and control of radio broadcasting stations." Since 1978, the FCC has exercised this authority 356 times to help promote minority ownership of broadcast and cable facilities. In addition, the FCC has used tax certificates over 100 times to facilitate sales that were necessary under the FCC's multiple ownership rules. Tax certificates are also available to relocate microwave licensees to other frequencies to make room for personal communications services. Such certificates can also be used as incentives for owners of AM radio to divest themselves of licenses in certain frequency bands in order to reduce interference.

A fundamental tenet of the Communications Act of 1934 was to increase the diversity of viewpoints available through the mass media. With the advent of new delivery systems for video programming, such as cable and direct broadcast satellite, the number of outlets is increasing. Nevertheless, the cost of obtaining a radio or television license or a cable facility continues to increase. In fact, the average price of a television station is $17 to $35 million.

Minority ownership in the telecommunications field remains very low compared with minority representation in the population as a whole; as of June 1994, only 2.9 percent of radio and television stations, or 323 out of 11,128, were controlled by minorities. In cable, only 0.2 percent, or 15 out of approximately 7,500 cable operators, were minority-controlled.

In 1982, the Commission's Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications found that financing was the "single greatest obstacle" to the entry of minorities into the telecommunications industry. Given the capital-intensive nature of this industry, many minorities will not be able to finance purchases without the benefit of the FCC's tax certificate program.

By alleviating continuing difficulties in accumulating capital, the tax certificate program helps to create opportunities for minorities in broadcasting and cable. It also ensures that a diversity of voices is heard by the American public.

While concerns have been raised about potential abuses of this program, such concerns must not obscure the public benefits of the program. We note that, in fact, the tax certificate is most often used for relatively small purchases, usually radio station licenses. There is no evidence that minority-owned firms have used the tax certificate program as a vehicle to "flip" media properties. Of the nearly 300 broadcast transactions in which tax certificates were granted between 1978 and 1993, the average holding period was approximately five years.

The Administration recognizes that any program could benefit from a careful review. Section 1071 and the use of tax certificates is no exception. While the Administration opposes outright repeal of Section 1071, we look forward to working with Members of Congress and the FCC in reviewing the program.

Personal Communications Industry Association

STATEMENT FOR THE RECORD: THE PERSONAL COMMUNICATIONS INDUSTRY ASSOCIATION (PCIA)

SENATE FINANCE COMMITTEE HEARING MARCH 7, 1995

FEDERAL COMMUNICATION COMMISSION USE OF TAX CERTIFICATES UNDER THE AUTHORITY OF SECTION 1071 OF THE INTERNAL REVENUE CODE

SUMMARY

1. The use of tax certificates is not limited to members of minority groups, but is a long-established instrument for spectrum management affecting a wide range of companies, regardless of the status of corporate or individual ownership.

2. Tax certificates are a principal means for complying with the mandate of Congress that incumbent spectrum users not bear the costs associated with the relocation necessary to make the most efficient use of the radio spectrum.

3. Repeal of Section 1071 would have a large and negative impact on Personal Communication Service (PCS) companies now bidding for licenses at auctions and who have counted on tax certificates as a part of the value of markets and expenses to be incurred in constructing the next generation of wireless telecommunication services.

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PCIA is the consolidation of the Personal Communications Industry Association and the National Association of Business and Educational Radio

STATEMENT OF THE PERSONAL COMMUNICATIONS INDUSTRY ASSOCIATION

FOR INCLUSION IN HEARING RECORD

SENATE FINANCE COMMITTEE HEARING MARCH 7, 1995 ON THE USE OF FCC TAX CERTIFICATES AUTHORIZED BY SECTION 1071 OF THE INTERNAL REVENUE CODE

The Personal Communications Industry Association (PCIA) welcomes and appreciates the opportunity to comment on the merits of recently House-passed legislation, H.R. 831, which would repeal Section 1071 of the Internal Revenue Code.

PCIA, founded over 40 years ago, represents virtually all aspects of the wireless industry. Originally established to represent the paging industry, our trade association now encompasses cellular telephone companies and through its Personal Communications Services group, computer, cable, equipment manufacturers, local exchange and interexchange carriers, Regional Bell Telephone Companies and Enhanced Specialized Mobile Radio (ESMR) companies. Merged in 1994 with the National Association of Business and Education Radio (NABER), the association's membership now includes another 2,300 corporations and individuals involved in private carrier paging (PCP), Specialized Mobile Radio (SMR) owners and operators, manufacturers, wireless system integrators, communications site owners and managers, dealers, service professionals and end users.

The Committee is to be commended for holding a thorough hearing before proceeding in consideration of the House-passed legislation. PCIA believes the legislation is ill-advised and will result in substantial harm to the wireless telecommunications industry, particularly the emerging Personal Communications Service (PCS) companies which are now bidding for spectrum to provide service.

Much of the oral and written testimony presented to the Committee has focused on the impact of the legislation on minority ownership of communications entities. Although that line of inquiry is absolutely valid, it is equally important to recognize that the impact of repealing tax certificates will have far broader implications on the telecommunications industry. Use of tax certificates is not limited to members of minority groups, but are used by a wide variety of telecommunications companies without regard to the nature of their ownership.

Tax certificates have been used by the FCC for approximately 50 years to help facilitate transfers of facilities that serve a public good in the management of the radio spectrum and implementation of public policy as determined by the FCC and Congress. Initially, tax certificates were used when the FCC, acting to accomplish a public policy objective, took actions that without the use of tax certificates or other ameliorating actions, would have created a

substantial hardship. Tax certificates been used since 1970 in voluntary transfers, but are, of course, limited to transactions that accomplish broad public policy objectives. In the case of PCS companies, the FCC determined where service should be provided on the spectrum. Under current technology, PCS services must be provided in that portion of the electromagnetic spectrum below 3 GHz and 1850 to 1990 MHz was allocated for this purpose. Virtually all of this spectrum is current being used by a entities to provide a wide range of wireless communications services. In order to facilitate the removal and relocation of the incumbent users, the FCC established a process that encourages the voluntary relocation of existing users.

A central element in that process is the ability of the new PCS companies to have tax certificates available as a part of the negotiations which will hopefully result in parties agreeing to relocation of incumbent users. <u>In the summer of 1992, the Congress exerted considerable time and effort to ensure that the costs associated with relocating incumbent spectrum users must be borne by the new PCS licensees. Tax certificates are a principal instrument to minimize the costs associated by all parties in making spectrum use the most efficient, economic and productive.</u>

It is important to stress that the microwave relocation process is and has been underway for some time by those who are certain to provide PCS services, either through commitment to purchasing licenses in strategically vital markets or who are currently moving ahead in the construction of facilities by early licensing. The first set of auctions for broadband PCS licenses concluded just yesterday, bringing over $7.0 billion in to the U.S. Treasury. Those bidding for licenses have with certainty already taken into consideration the availability of tax certificates as a part of the total cost of establishing PCS service and thus calculated it as part of the ultimately value of licenses and how much they were willing to bid. Enactment of legislation now repealing the certificates would have an adverse impact on the value of licenses for which companies have been bidding since December, 1994..

Repeal of Section 1071 would have a major and negative impact on the PCS industry which already faces formidable barriers in establishing service which entrenched competitors did not. It is also important to recognize that the existing competitors of PCS used tax certificates when that industry was established more than a decade ago. At the time, the FCC determined that the development and availability of wireless mobile audio service was a valid and necessary public policy goal. Repealing Section 1071 now would create an additional barrier for PCS not faced by its competitors and thus create even more disparities between parts of what are to be a fiercely competitive industry. Such competition, ultimately of great public benefit, cannot exist of some participants have constraints and costs not borne by imbedded, existing providers. Ultimately, the public and consumers will be the losers

Lastly, it is important to have the perspective that with the tremendous growth of wireless telecommunications and the potential for advanced technologies in the future providing additional services to the public, tax certificates will become an even more important tool in the management of the wireless spectrum. The FCC must have maximum flexibility in determining methods and process for spectrum relocation and ownership issues. The ability of the agency to facilitate movement of incumbent spectrum users will be critical to the future growth and success of the wireless telecommunications industry.

PCIA urges the Committee to consider all the implications that would result from enactment of H.R. 831 and to reaffirm the need for tax certificates by not recommending its enactment of the Senate

TESTIMONY OF THE HONORABLE CHARLES B. RANGEL
ON SECTION 1071 OF THE INTERNAL REVENUE CODE AND MINORITY
PREFERENCES
BEFORE
THE COMMITTEE ON FINANCE OF
THE UNITED STATES SENATE
MARCH 7, 1995

Mr. Chairman, distinguished members of the Committee, and especially Senators Moynihan and D'Amato, my collegaues from New York, I am very glad to have this opportunity to testify before you on this very important matter that represents the first consideration in this new Congress of an affirmative action provision.

I am very concerned about the repeal of section 1071 of the Internal Revenue Code, about its retroactive repeal, about whether the repeal will result in the revenue anticipated, about the impact such repeal will have on the ability of minorities to participate in the broadcast business as owners and operators and about the statement repeal would make about the nation's committment to social justice.

I am particulary concerned that this bill is an element of of a wedge being driven within our society between people based on racial and ethnic grounds. It disturbs me that this bill may represent a trend to legislatively undo statutory and other means for providing opportunity for minorities previously denied by either overt or benign discrimination. I fear that this bill could represent this Congress's first step in dismantling the efforts to assure that minorities can truly have equal opportunity in the American society. The repeal of section 1071 represents a move to again close the door on minorities keeping them out of the mainstream of America. It is insensitive to the aspirations of the African-American, Hispanic, Native American and Asian communities.

While I can understand the need to move quickly on the provision for the extension of the deduction of health insurance costs of the self-employed because tax filing dates are soon upon us, I cannot understand the rush to repeal section 1071 of the Internal Revenue Code other than to retroactively impact a completely legal transaction that some for whatever reasons does not favor.

What most concerns me with the proposals to repeal section 1071 is the movement of Congress to begin to undo the progress this nation has made to provide opportunity for minorities to fully participate in the economy and social fabric of our nation. I fear that this

is part of national movement expressed in part by the Majority Leader of this body and by actions in the states such as the petition movement in California, to undo the efforts of affirmative action to fulfill the promise of America for all of its citizens.

I want to believe it is not a considered effort to deny the rights of minorities. Indeed, members of the majority in the House indicated all they want to do is to remove preferences from the tax code as well as to make the code color blind. However, in the face of a tax code that is replete with tax preferences, and as an American who has seen and lived racial prejudice in a society that in many ways continues to condone it, I cannot interpret the intention of the majority as anything but a response to the fears of Americans about race and equal opportunity. They believe the tax code should be cleansed of preferences. In the contextof opposing tax preferences, I can appreciate the opposition to this tax preference. I am concerned about starting tax reform with this preference. Why are we not dealing with a a more complete list of preferences to be repealed?

Admittedly section 1071 creates a preference. But, it is not much different than any other preference which is designed to achieve a public policy goal. Its goal is to effectuate Federal Communications Commission (FCC) policies about diversity ownership of broadcast licenses. The original impetus was the FCC policy to prevent monopoly ownership of broadcast facilities in a community. The FCC instituted a policy to force sales to break up monopolies. Section 1071 provided relief for owners forced to sell. Since 1978 this policy has been broadened to provide tax benefits for voluntary sales. The basis of such relief is similar to the proposal to compensate property owners inhibited by environmental regulations.

By the late 1960s the FCC came to the conclusion that diversity in ownership among the many racial and ethnic groups was an important goal if the scarce airwaves were to serve all Americans. However, despite all of the Commission's efforts to achieve diversity there was not much success. Though African Americans and Hispanics together represent about 20% of the population, by 1978 when the FCC adopted the minority preference rule minorities held less than 1% of the broadcast licenses.

The need for diversity was and still is clear. This member, an African American, grew up in segregated America where the only impressions from the media of African Americans and Hispanics were negative role models of savage African natives saved from their ignorance by a white man in a loin cloth, or shuffling Black slaves, or *Amos 'n Andy* ,or Mexicans sneering or in perpetual siesta. Up through the 1960s and into the 1970s it

was difficult for minorities to view TV or listen to the radio and find positive role models. The need to present positive role models for our young continues to plague minority communities. The need to express our views among ourselves and to the larger community remains difficult. The need to develop economic independence remains great. Yet for years entire minority communities had no electronic media outlet for their views or for their entrepreneurs to advertise products and services to their own communities

Thus, in 1978 the FCC adopted the current policy to provide tax certificates to those who sold broadcast properties to minorities.[1]

Some argue that there might be better ways to encourage minority ownership. But the history indicates otherwise. This is the best way. The FCC had tried other means, but they were not successful.

The FCC expanded the rule during in 1982 to include the sale of cable systems[2].

Despite the application of section 1071 since 1978 the proportion of licenses in minority hands has only climbed to about 3%. There have been about 330 licenses transfers (260-radio; 40 TV; and 30 cable) where the preference was a factor. During the same period there have been over 15,000 license transactions. Over half of the licenses transferred pursuant to the preference are still in minority control.

It is clear the preference was enacted by Congress to provide the FCC with a tool to manage the airwaves that belong to all Americans. An important responsibility of the FCC is to assure that all Americans have reasonable access to the airwaves. The preference of section 1071 allows the FCC to fulfill this responsibility.

It is not unlike a preference designed by Congress to assure energy independence. Congress has for many years sustained oil depletion allowances, deductions for intangible drilling costs and exceptions to the alternative minimum tax for oil drilling to assure that the nation will have an adequate supply of oil. It matters not that in economic terms all that

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[1] *Statement of Policy on Minority Ownership of Broadcasting Facilities*, 68 FCC 2d 979 (1978).

The Supreme Court upheld the preference in *Metro Broadcasting v. FCC*, 497 U.S. 547 (1990). The Court looked at the Congressional action and came to the conclusion that Congress was very clear about support for the program.

[2]. *Statement of Policy on Minority Ownership of CATV Systems*, 52 R.R. 2d 1452 (1982). See also, *Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting*, 92 FCC 2d 849 (1982).

these preferences do is encourage drilling at lower breakeven points. Should the price of oil be higher than the cost of drilling the savings from the preference does not go to the consumer, but the oil drilling entrepreneur.

Is it important for the nation to be energy independent at the expense of lost tax revenues that flow to well-off energy companies and individual investors? Congress has consistently answered yes. Is it important at the expense of lost tax revenues to insure among the scarce airwaves that there be be representation of as many of America's diverse communities. I believe the answer is also yes.

There is concern about an agency other than the Internal Revenue Service deciding who gets a tax preference. There are several provisions in the code that cede authority to define preferences to an agency other than the IRS. For example, the code clearly allows a taxpayer to take a credit for the rehabilitation of a property listed on the national register of historic sights. However, it is the the Department of the Interior that sets the regulations and decides whether a property is on the historic register and, therefore, eligible for an historic rehabilitation credit.

Why is there a need for a tax preference to encourage minority ownership of broadcast properties. Congress has been quite clear that it wants to provide tax relief in order that where the FCC found it:

> "...necessary or appropriate to effectuate a change in policy of, or the adoption of a new policy of the Commission with respect to ownership and control of radio broadcasting stations." (radio being used generically to apply to TV and cable as well). IRC §1071.

I am sure that there will be considerable testimony given at these hearings indicating that without the preference it was difficult, if not impossible for minorites to secure broadcast properties.

At the hearings before the Subcommittee on Oversight of the Committee on Ways and Means Percy Sutton testified he worked for seven years looking for financing and the opportunity to buy his first station, WLIB. This station satisfied a market previously unrecognized in New York--African-American talk radio.

Raul Alercon, who is testifying at this hearing, testified at the same House hearing that his family fled from Cuba after losing their radio stations to Castro. They were

determined to start again in America. They used the preference and began a chain of Spanish language radio stations that includes the fifth most popular FM station in the New York market. Prior to the Alercon family's investment no one in the radio business thought of the potential profit in serving the large Hispanic market in New York. There was no Spanish language FM station in New York even though there was money to be made until the preference made it possible for the Alercon family to start their station.

There is evidence that minorities often do not get a break on the price of broadcast properties because of the preference. That is not the issue. The problem was never price. The majority of transactions involve entrepreneurs who have struggled to enter the broadcast business. They have always been willing to pay market prices. The average radio transaction has about $3.5 million, television transaction about $38 million. The issue has always been access to a closed society of broadcast entrepreneurs. The Ways and Means Subcommittee heard several witnesses, and I am sure that you will, indicate until this preference was established those who sold and brokered radio and TV stations would not open their doors to minorities. Now with the preference minorities are noticed in the market place.

You will hear evidence that there have been abuses with the use of the preference. There are many, including minority broadcasters, who believe the FCC should be allowed to make changes to improve the program.[3]. They believe that reforms that will insure the goal of diversity are truly achieved are in order.

Though the average holding period has been five years, and over and over 100 licenses transferred to minorites over the sixteen years the preference has been in effect are still in the same hands, there have transactions where the minority sold out within a year. A longer holding period may be in order.

Most transacations involve true minority ownership and control. However, there have been transactions where the minority's interest in the profits and equity of the property was not truly in conformity with the FCC rules. Rules to better define ownership and control are in order.

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[3] Congress has barred the FCC from changing its rules implementing the preference. Pub. L. No. 100-202, 101 Stat. 1329.

Some of the properties held by minorities have not resulted in diversity of format or opportunities for minorites to work in broadcasting. Consideration could be given to requiring intentions to provide diversity and opportunity.

Congressman Jim McDermott of Washington offered a substitute that dealt with the abuses. It tightens the rules on ownership and the holding period as well as limiting the amount of gain that can be deferred. Although it did not carry the House, (I support the concept of amendment, but I did not vote for the amendment on the floor because it would be applied retroactively like the underlying legislation.) it is safe to say the amendment has substantial support.

I am concerned about the retroactive features of the bill passed by the House. They go significantly beyond any retroactive features of recent legislation in that they are clearly designed to "rifle shot" at one particular transaction. It is not in the nature of Congress to pass legislation that is retroactively directed at one taxpayer involved a particular transaction. Congress has in recent years become reluctant to pass any legislation that is a "rifle shot" directed in favor any taxpayer. It should be as reluctant to pass such legislation designed to deny a heretofore legal tax preference.

The bill to repeal section 1071 was introduced in the House on February 6, 1995, yet the repeal section 1071 applies to sales and transactions on or after January 17, 1995. The sponsor of the bill justifies this effective date by citing the press release from the Committee on Ways and Means of January 17, 1995, announcing a review of section 1071 and the hearing of its Subcommittee on Oversight on January 27, 1995, quoting the Chair. "Any changes to section 1071 may apply to transactions completed, or certificates issued by the FCC, on or after today, January 17, 1995."

There is no question about why January 17, 1995, is the effective date in this legislation. It clearly is to stop section 1071 from applying to the largest transaction ever benefiting by section 1071. The sponsor was aware as of January 17, as many who read the business press, that Viacom had recently announced an intention to enter into an agreement to sell its cable television systems for approximately $2.3 billion to a partnership of Mitgo Corp., a company wholly owned by Frank Washington, an African American, and affiliates of InterMedia Partners. The agreement was signed on January 20, 1995, and is contingent upon the FCC granting the certificates necessary for claiming the benefits of section 1071.

While there may be other transactions pending as of this date, there has been no evidence of these transactions presented to Congress.

There is no question that this retroactive effective date is directed at one earnest African American businessman. This man has built a successful cable business. He intends to increase its size to achieve economies of scale to effectively compete in what other committees of this House have found to be an extraordinarily dynamic and competitive business. But, despite his entrepreneurial efforts well within the law, the majority of the Committee has decided that he has become too successful.

I am concerned that the message of this legislation to minorities in this nation is that when you become too successful it will not matter whether you played by the rules--you will be allowed to go just so far.

I am concerned that the way this legislation is directed at the Viacom deal it is unlikely that the revenue estimates of the Joint Committee on Taxation can be sustained.

A significant part of the revenue anticipated from the repeal of section 1071 is assumed to be the revenue lost from the Viacom transaction. A revenue estimate assumes a baseline of activities that will be altered by the legislation in question. How can the baseline include the Viacom transaction when it has become moot. If the legislation is enacted as reported, then there is no contract between Viacom and the Mitgo Corp.-InterMedia Partners partnership. The agreement was contingent upon securing the FCC certificate for section 1071 treatment. It is rank speculation to assume in the baseline what Viacom will do if the agreement is voided. There is also no evidence of what tax impact will be on Viacom or any other taxpayer who might alternatively purchase the cable properties. The facts are clear that most transfers of cable properties are done through some tax deferred arrangement. In fact, it was reported in the *Wall Street Journal* on the morning of the day this bill was reported by the Committee on Ways and Means that Time Warner was purchasing cable properties from Cablevision in a transaction that it intended to be a tax free or deferred reorganization[4].

I appreciate your allowing me to testify before you. This issue is more important than whether a cable television system is transferred to a partnership with significant minority ownership. What is more important is what this legislation implies about our nation's commitment to social justice and the ability of minorities to fully participate in the American economy and culture.

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4. *Wall Street Journal*, February 8, 1995 at A3

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March 14, 1995

COMMENTS OF WINDKEEPER COMMUNICATIONS, INC.
ON H.R. 831 (FCC TAX CERTIFICATE PROGRAM)

To: Editorial Section
United States Senate
Committee on Finance
Washington, D.C. 20510

Windkeeper Communications, Inc., by its attorneys, hereby submits these Comments in connection with the Committee's consideration of H.R. 831 which proposes to repeal the tax certificate program administered by the Federal Communications Commission ("FCC"). Windkeeper Communications, Inc. is a company formed and owned by a woman, Zoë Hazen, to participate in the Entrepreneurs' Block auctions for Personal Communications Service ("PCS") licenses. Ultimately, Windkeeper hopes to construct and operate PCS systems in various markets throughout the United States.

As the Committee is aware, the FCC is planning to utilize the tax certificate program in several ways to assist PCS businesses controlled by women and minorities. Most significantly, perhaps, is the plan to provide tax certificates to initial investors who provide "start-up" financing to minority and woman-owned PCS businesses. While this would appear at first blush to be a significant benefit to such businesses, it is absolutely necessary to place them on an equal footing with non-minority and non-woman owned businesses.

In the Communications Act, Congress specifically mandated that the FCC "ensure that small businesses, rural telephone companies, and businesses owned by members

of minority groups and women are given the opportunity to participate in the provision of spectrum-based services." 47 U.S.C. § 309(j)(4)(D). Indeed, Congress specifically required the Commission to "consider the use of tax certificates" as a means of achieving this goal. *Id.* The reasons for establishing this goal, and for providing a means by which to achieve it, are not difficult to understand. But it is critically important that the Committee understand these reasons before repealing with one fell swoop the well thought-out policies established by Congress and the FCC.

In determining to utilize the tax certificate policy for woman and minority-owned PCS businesses, the FCC noted Congress' finding that businesses owned by minorities and women face "extraordinary" difficulties in obtaining access to capital.[1] In 1988, Congress had previously found that women are subject to discrimination that adversely affects their ability to raise or secure capital in enacting the Women's Business Ownership Act.[2]

The problems that woman-owned businesses face in attracting capital is also reflected in the underrepresentation of such businesses in both the broadcast and non-broadcast telecommunications industries. According to the most recent U.S. Census, "only 24 percent of the communications firms in the country were owned by women, and these women-owned firms generated only approximately 8.7 percent of the revenues earned by communications companies."[3] As a result of these low numbers, very few women-owned businesses have communications experience, which thus increases the barrier women-owned businesses face in attracting capital for a new communications technology such as PCS. *Id.*

According to a 1993 study prepared by the National Foundation for Women Business Owners, "women-owned firms are 22 percent more likely to report problems dealing

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[1] *Fifth Report and Order in PP Docket No. 93-253*, 9 F.C.C. Rcd. 5532 ¶ 98 (1994), *citing Small Business Credit and Business Opportunity Enhancement Act of 1992*, § 331(a)(3), Pub. L. 102-366, Sept. 4, 1992.

[2] *Fifth Report and Order*, ¶ 101, *citing* Pub. L. 100-533 (1988).

[3] *Fifth Report and Order*, ¶ 107.

with their banks than are businesses at large."[4] It is not enough to say merely that we need to prevent discrimination by lenders, since such discrimination is usually quite difficult to prove. The Federal Reserve Bank of Boston found that, "because most loan applicants have some negative attributes, most loan denials will appear legitimate by some objective standard."[5] Since lending discrimination is very difficult to document, legal remedies are largely ineffective. *Id.*

The measures established by the FCC to encourage investment in woman and minority-owned PCS businesses are designed not only to attract start-up capital, but to "promote strong, long-term *bona fide* competitors."[6] If Congress eliminates this significant benefit established by the FCC at the urging of Congress, the end result would be to perpetuate the very problems Congress and the FCC have so carefully sought to address. The Committee is well aware of the underrepresentation of minority and woman-owned broadcast businesses. PCS represents a new technology that will be of great significance in the years ahead as licenses are awarded and systems are built. Congress and the FCC have recognized that there is a unique opportunity to avoid the past discrimination problems that have arisen in established communications industries like broadcasting and cable. Recognizing this opportunity, Congress and the FCC have carefully crafted a framework designed to foster the establishment of women and minority-owned PCS businesses from the beginning of this new industry. If this opportunity is lost, the past discriminations will undoubtedly continue to perpetuate with PCS and, because they are so insidious, they will continue to be difficult to prove. Additionally, any change in FCC rules mandated by repeal of the tax certificate policy is likely to set back the entire PCS industry for months, if not years, while the FCC begins the rulemaking process anew.

For the foregoing reasons, Windkeeper Communications urges the Committee to reject this bill. Alternatively, if the Committee feels there are problems that need to be addressed with regard to the use or abuse of the FCC's tax certificate policy, we urge that

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[4] *Fifth Report and Order*, ¶ 102.

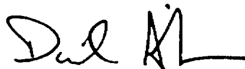
[5] *Fifth Report and Order, citing Mortgage Lending in Boston: Interpreting HMDA Data Federal Reserve Bank of Boston, Working Paper 92-7* (October 1992).

[6] *Fifth Report and Order*, ¶ 112.

those problems be addressed specifically, *e.g.*, through the use of a cap on benefits. Repealing the entire tax certificate policy is akin to killing a flea with a sledgehammer and, more importantly, would constitute a severe setback to the important goals established over time by Congress and the FCC to help eliminate discrimination in the communications industry.

Respectfully submitted,

WINDKEEPER COMMUNICATIONS, INC.

By: 
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BACKGROUND AND ISSUES RELATING TO: (1) THE APPLICATION OF CODE SECTION 1071 UNDER THE FEDERAL COMMUNICATIONS COMMISSION'S TAX CERTIFICATE PROGRAM; (2) INVOLUNTARY CONVERSIONS UNDER CODE SECTION 1033; AND (3) THE EARNED INCOME TAX CREDIT

Scheduled for a Public Hearing

Before the

SENATE COMMITTEE ON FINANCE

on March 7, 1995

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

March 6, 1995

JCX-8-95

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INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on March 7, 1995, on the application of Internal Revenue Code ("Code") section 1071 under the Federal Communications Commission's ("FCC") tax certificate program.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides background information on Code section 1071 and the FCC tax certificate program. Part I of the document provides information on the background of Code section 1071 and the administration of the FCC tax certificate program, and discusses economic and tax policy issues concerning the application of Code section 1071. Part II of the document describes Code section 1033 regarding the tax treatment of involuntary conversions. Part III of the document describes certain provisions of H.R. 831, as passed by the House of Representatives on February 21, 1995, which repeal Code section 1071 and modify Code section 1033. Part IV of the document discusses certain aspects of the earned income tax credit ("EITC"), which is the subject of certain proposals included in the Administration's fiscal year 1996 budget submission. Specifically, Part IV of the document provides an overview of the EITC, and describes the Administration's proposal to modify the EITC, as well as the modifications to the EITC contained in H.R. 831.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Background and Issues Relating to: (1) the Application of Code Section 1071 Under the Federal Communications Commission's Tax Certificate Program; (2) Involuntary Conversions Under Code Section 1033; and (3) the Earned Income Tax Credit* (JCX-8-95), March 6, 1995.

I. CODE SECTION 1071 AND THE FCC TAX CERTIFICATE PROGRAM

A. Background of Code Section 1071

Code section 1071 was originally enacted as part of the Revenue Act of 1943 to help the FCC implement a new policy that prohibited licensees from owning more than one radio station per market.[2] Congress believed that the involuntary conversion[3] rules (which generally permitted gain on sales of other dispositions of involuntarily converted property to be excluded from taxable income if the proceeds were reinvested in property similar to the property involuntarily converted) should be applied to these transactions, but needed to be liberalized for sales ordered by the FCC because, "[d]ue to wartime restrictions, the purchase of new radio property [would have been]... difficult."[4]

As initially reported by the Senate Committee on Finance in 1943, the provision would have allowed a rollover if the sale or exchange of the property were required by the FCC as a condition of the granting of an application.[5] However, the conference report stated that because "the Commission does not order or require any particular sale or exchange, it has been deemed more appropriate to provide that the election, subject to other conditions imposed, shall be available upon certification by the Commission that the sale or exchange is necessary or appropriate to effectuate the policies of the Commission with respect to ownership or control of radio broadcasting stations."[6]

In 1954, this provision was adopted as section 1071 of the 1954 Code without change. In adopting the provision, Congress noted that the term "radio broadcasting" has an "established meaning in the industry and in the administration of the Federal Communications Act which is sufficiently comprehensive to include telecasting [i.e., television]."[7]

In 1958, Code section 1071 was amended to provide that the tax certificates should be granted only when the FCC certified that a disposition was necessary or appropriate to effectuate a change in the policy of, or the adoption of a new policy by, the FCC.[8] Congress was

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[2] Revenue Act of 1943, Pub. L. 78-235, sec. 123.

[3] An involuntary conversion is generally defined by the Code to occur only when property is compulsorily or involuntarily converted as a result of its destruction, in whole or in part, by theft, seizure, or requisition or condemnation or threat or imminence thereof. Code sec. 1033(a).

[4] S. Rept. No. 627, 78th Cong., 1st Sess., 23 (1943).

[5] S. Rept. No. 627, 78th Cong., 1st Sess., 23, 53-54 (1943).

[6] H. Rept. No. 1079, 78th Cong., 2d Sess., 49-50 (1943).

[7] S. Rept. No. 1622, 83rd Cong. 2d Sess., 429 (1954).

concerned that taxpayers had "on occasion purchased additional facilities in excess of the maximum number of facilities permitted under then existing FCC rules, and then obtained a certification from the FCC that the disposition of the older facility was necessary or appropriate, thereby obtaining tax deferment on the gain from the sale."[9] In response to this practice, the FCC announced that in the future it would grant tax certificates only where the disposition was required because of a change in FCC policy or rules with respect to the ownership and control of broadcast facilities.[10] In adopting the 1958 changes, Congress agreed that "the announced policy of the FCC in the Federal Register is a desirable way of eliminating these voluntary transactions from the application of Code section 1071."[11]

The term "radio broadcasting" was expanded to include cable television in 1973.[12] The use of FCC tax certificates was recently expanded in connection with the auction of personal communications services (see discussion in Part I.B.1.).

B. FCC Administration of Tax Certificate Program

1. FCC tax certificate program

Multiple ownership policy

The FCC originally adopted multiple ownership rules in the early 1940s.[13] These rules prohibited broadcast station owners from owning more than one station in the same service area, and, generally, more than six high frequency (radio) or three television stations. Owners wishing to acquire additional stations had to divest themselves of stations they already owned in order to remain in compliance with the FCC's rules.

In November 1943, the FCC adopted a rule that prohibited duopolies (ownership of more than one station in the same city).[14] After these rules were adopted, owners wishing to acquire

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[8] Technical Amendment Act of 1958, Pub. L. 85-866, sec. 52.

[9] S. Rept. No. 1983, 85th Cong., 2d Sess., 73-74 (1957).

[10] FCC Policy for Tax Certificates, 21 Fed. Reg. 7831 (Oct. 13, 1956).

[11] H. Rept. No. 775, 85th Cong., 1st Sess., 29-30 (1957).

[12] Rev. Rul. 73-73, 1973-1 C.B. 371.

[13] 5 Fed. Reg. 2382 (June 26, 1940) (multiple ownership rules for high frequency broadcast stations); 5 Fed. Reg. 2284 (May 6, 1941) (multiple ownership rules for television stations)

[14] 8 Fed. Reg. 16065 (Nov. 23, 1943).

additional stations in excess of the national ownership limit had to divest themselves of stations they already owned in order to remain in compliance with the FCC's rules. After Code section 1071 was adopted in 1943, in some cases, parties petitioned the FCC for tax certificates pursuant to Code section 1071 when divesting themselves of stations. These divestitures were labeled "voluntary divestitures" by the FCC. When the duopoly rule was adopted, 35 licensees that held more than one license in a particular city were required by the rule "involuntarily" to divest themselves of one of the licenses.[15]

Minority ownership policy

In 1978, the FCC announced a policy of promoting minority ownership of broadcast facilities by offering an FCC tax certificate to those who voluntarily sell such facilities (either in the form of assets or stock) to minority individuals or minority-controlled entities.[16] The FCC's policy was based on the view that minority ownership of broadcast stations would provide a significant means of fostering the inclusion of minority views in programming, thereby serving the needs and interests of the minority community as well as enriching and educating the non-minority audience. The FCC subsequently expanded its policy to include the sale of cable television systems to minorities as well.[17]

"Minorities," within the meaning of the FCC's policy, include "Blacks, Hispanics, American Indians, Alaska Natives, Asians, and Pacific Islanders."[18] As a general rule, a minority-controlled corporation is one in which more than 50 percent of the voting stock is held by minorities. A minority-controlled limited partnership is one in which the general partner is a minority or minority-controlled, and minorities have at least a 20-percent interest in the partnership.[19] The FCC requires those who acquire broadcast properties with the help of the FCC tax certificate policy to hold those properties for at least one year.[20] An acquisition can qualify

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[15] FCC Announces New Policy Relating to Issuance of Tax Certificates, 14 FCC2d 827 (1956).

[16] Minority Ownership of Broadcasting Facilities, 68 FCC2d 979 (1978).

[17] Minority Ownership of Cable Television Systems, 52 R.R.2d 1469 (1982).

[18] 52 R.R.2d at n. 1.

[19] Commission's Policy Regarding the Advancement of Minority Ownership in Broadcasting, Policy Statement, and Notice of Proposed Rulemaking, 92 FCC2d 853-855 (1982).

[20] See Amendment of Section 73.3597 of the Commission's Rules (Applications for Voluntary Assignments or Transfers of Control), 57 R.R.2d 1149 (1985). Anti-trafficking rules require cable properties to be held for at least three years (unless the property is sold pursuant to a tax certificate).

even if there is a pre-existing agreement (or option) to buy out the minority interests at the end of the one-year holding period, providing that the transaction is at arm's-length.

In 1982, the FCC further expanded its tax certificate policy for minority ownership. At that time, the FCC decided that, in addition to those who sell properties to minorities, investors who contribute to the stabilization of the capital base of a minority enterprise would be entitled to a tax certificate upon the subsequent sale of their interest in the minority entity.[21] To qualify for an FCC tax certificate in this circumstance, an investor must either (1) provide start-up financing that allows a minority to acquire either broadcast or cable properties, or (2) purchase shares in a minority-controlled entity within the first year after the license necessary to operate the property is issued to the minority. An investor can qualify for a tax certificate even if the sale of the interest occurs after participation by a minority in the entity has ceased. In these situations, the status of the divesting investor and the purchaser of the divested interest is irrelevant, because the goal is to increase the financing opportunities available to minorities.

Since fiscal year 1988, in appropriations legislation, the Congress has prohibited the FCC from using any of its appropriated funds to repeal, to retroactively apply changes in, or to continue a reexamination of its comparative licensing, distress sale and tax certificate policies.[22] This limitation has not prevented an expansion of the existing program.[23]

Personal communications services ownership policy

In 1993, Congress provided for the orderly transfer of frequencies, including frequencies that can be licensed pursuant to competitive bidding procedures.[24] The FCC has adopted rules to conduct auctions for the award of more than 2,000 licenses to provide personal communications services ("PCS"). PCS will be provided by means of a new generation of communication devices that will include small, lightweight, multi-function portable phones, portable facsimile and other imaging devices, new types of multi-channel cordless phones, and advanced paging devices with two-way data capabilities. The PCS auctions (which began last year) will constitute the largest auction of public assets in American history and are expected to generate billions of dollars for the

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[21] Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC2d 849 (1982).

[22] Pub. L. No. 100-202 (1987).

[23] The appropriations restriction "does not prohibit the agency from taking steps to create greater opportunity for minority ownership." H. Conf. Rep. No. 103-708, 103d Cong. 2d Sess. 40 (1994).

[24] Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, Title VI.

United States Treasury.[25]

The FCC has designed procedures to ensure that small businesses, rural telephone companies and businesses owned by women and minorities have "the opportunity to participate in the provision" of PCS, as Congress directed in 1993.[26] To help minorities and women participate in the auction of the PCS licenses, the FCC took several steps including up to a 25-percent bidding credit, a reduced upfront payment requirement, a flexible installment payment schedule, and an extension of the tax certificate program for businesses owned by minorities and women.[27]

The FCC will employ the tax certificate program in three ways: (1) initial investors (who provide "start-up" financing or purchase interests within the first year after license issuance) in minority and woman-owned PCS businesses will be eligible for FCC tax certificates upon the sale of their investments; (2) holders of PCS licenses will be able to obtain FCC tax certificates upon the sale of the business to a company controlled by minorities and women; and (3) a cellular operator that sells its interest in an overlapping cellular system to a minority or a woman-owned business to come into compliance with the FCC PCS/cellular cross-ownership rule will be eligible for a tax certificate.

Microwave relocation policy

PCS can operate only on frequencies below 3GHz. However, because that frequency range is currently occupied by various private fixed microwave communications systems (such as railroads, oil pipelines, and electric utilities), there are no large blocks of unallocated spectrum available to PCS. To accommodate PCS, the FCC has reallocated the spectrum; a portion of the 2GHz spectrum will be used exclusively for PCS, and the microwave systems will be required to move to higher frequencies. Current occupants of the 2GHz spectrum allocated to PCS must relocate to higher frequencies not later than three years after the close of the bidding process (anticipated to end in March or April, 1995).[28] In accordance with FCC rules, these current occupants have the right to be compensated for the cost of replacing their old equipment, which can operate only on the 2GHz spectrum, with equipment that will operate at the new, higher frequency. At a minimum, the winners of the new PCS licenses must pay for and install new facilities to enable the incumbent microwave operators to relocate. The amount of these payments and characteristics of the new equipment will be the subject of negotiation between the incumbent microwave operators and the PCS licensees; thus, the nature of the compensation (i.e., solely replacement equipment, or a combination of replacement equipment plus a cash payment) is

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[25] Fifth Report and Order, 9 FCC Rcd 5532 (1994).

[26] Omnibus Budget Reconciliation Act of 1993, P.L. 103-66, section 6002(a).

[27] Installment payments are available to small businesses and rural telephone companies.

[28] The PCS auctions for portions of the 2GHz spectrum commenced in December, 1994.

unknown at present. If no agreement is reached within the 3-year voluntary negotiation period, the microwave operators will be required by the FCC to vacate the spectrum; however, the timing of such relocation is uncertain because the relocation would take place only after completion of a formal negotiation process in which the FCC would be a participant.

The FCC will employ the tax certificate program for PCS to encourage fixed microwave operators voluntarily to relocate from the 2GHz band to clear the band for PCS technologies.[29] Tax certificates will be available to incumbent microwave operators that relocate voluntarily within three years following the close of the bidding process. Thus, the certificates are intended to encourage such occupants to relocate more quickly that they otherwise would and to clarify the tax treatment of such transactions.[30]

2. **FCC interpretation of tax certificate program**

The standards for FCC tax certification have been progressively loosened over time. As noted above, in 1956, the FCC's construction of the term "necessary or appropriate" in Code section 1071 led it to require a showing of the involuntary nature of the divestiture.[31] However, in 1970, the FCC lessened the required showing to a "causal relationship" between the divestiture and the specific FCC policy, as a condition for the issuance of a certificate.[32] Subsequently, the FCC determined that voluntary divestitures that effectuate specific ownership policies are "appropriate," and eliminated the "causal relationship" requirements.[33] Further, in adopting the minority ownership policy described above, the FCC stated that "originally tax certification was used to remove the hardship of involuntary transfer as a result of divesture imposed by the Commission's multiple ownership rules. Now, however, tax certificates are routinely approved in voluntary sales . . . ."[34]

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[29] See, Third Report and Order and Memorandum Opinion and Order, 8 FCC Rcd 6589 (1993).

[30] The transaction between the PCS licensee and the incumbent microwave operator might qualify for tax-free treatment as a like kind exchange under Code section 1031 or as an involuntary conversion under Code section 1033. However, the availability of these Code provisions may be limited by certain technical requirements, including the treatment of cash in a like-kind exchange, and whether the transaction would qualify as an involuntary conversion under currently applicable IRS standards.

[31] FCC Announces New Policy Relating to Tax Certificates, 14 FCC2d 827 (1956).

[32] Issuance of Tax Certificates, 19 RR 1831 (1970).

[33] In re Issuance of Tax Certificates, 59 FCC2d 91 (1976).

[34] Minority Ownership of Broadcasting Facilities, 68 FCC2d 979 (1978).

3. Other FCC minority ownership programs

Apart from the FCC tax certificate program, there are other programs administered by the FCC to foster minority ownership. The FCC awards comparative merit in licensing proceedings to minority applicants in the interest of promoting minority entrepreneurship.[35] In addition, the FCC's distress sale policy allows broadcasting licensees whose licenses have been designated for revocation hearing, prior to the commencement of a hearing, to sell their station to a minority-owned or controlled entity, at a price "substantially" below its fair market value.[36] A licensee whose license has been designated for hearing would ordinarily be prohibited from selling, assigning or otherwise disposing of its interest until the issues have been resolved in the licensee's favor.

4. Data concerning FCC minority ownership programs

FCC tax certificate program

The FCC reports that it has issued 390 tax certificates since 1978.[37] Of that total, the FCC has issued 330 tax certificates under the minority ownership program[38] (an additional 18 certificates have been issued to parties contributing start-up capital to a minority-controlled entity to acquire broadcast or cable properties).[39] The majority (about 80 percent) of license transfers relating to minority ownership tax certificates involve radio properties, as would be expected because most outstanding licenses are for radio.[40]

The average sales price for the transactions in which tax certificates were granted was $3.5 million for radio, and $38 million for television.[41] No average sales price information is

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[35] Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC2d 849 (1982).

[36] Id.

[37] Statement of William E. Kennard, General Counsel of the FCC, before the Subcommittee on Oversight of the Committee on Ways and Means, January 27, 1995.

[38] Id.

[39] Letter from William E. Kennard, General Counsel of the FCC, to Kenneth J. Kies, Chief of Staff of the Joint Committee on Taxation, dated February 7, 1995.

[40] Statement of William E. Kennard, General Counsel of the FCC, before the Subcommittee on Oversight of the Committee on Ways and Means, January 27, 1995.

[41] Id.

available for cable system sales, although the average sales prices is expected to be much larger.[42] No information is available concerning the lost tax revenue associated with the transactions for which the FCC has issued tax certificates in minority ownership transfers because the FCC does not request such information.

FCC records indicate that four of 40 television licenses have been transferred by a minority-controlled entity after the license was acquired in a tax certificate transaction.[43] The average holding period for these four licenses prior to transfer was 2.25 years. In radio, 130 of 183 (71 percent) stations acquired in tax certificate transactions during the period 1979-1992 for which the FCC has data were sold at the close of 1992. The average holding period was 3.5 years. The FCC was unable to provide data on the number of cable licenses acquired in tax certificate transactions and the average holding period prior to transfer. No holding period data is available for transactions that do not involve tax certificates.

FCC minority ownership programs

There is no data that documents the overall effectiveness of the FCC minority ownership programs (including the tax certificate program) or the effectiveness of any particular FCC minority ownership program. Some limited empirical data exists on minority ownership of broadcast facilities generally. The National Telecommunications and Information Administration reports that minority persons hold 2.9 percent of all broadcast licenses.[44] This is an increase from the 1978 level estimated at 0.5 percent, but is lower than a peak of 3.0 percent attained in the mid-1980s.

5. Viacom transaction

On January 20, 1995, Viacom Inc. (a publicly-traded company) and Mitgo Corp., a company wholly owned by Frank Washington, an African American media executive, and affiliates of InterMedia Partners announced that they had signed a definitive agreement under which Viacom will sell its cable systems serving 1.1 million customers to a partnership, RCS-Pacific L.P., of which Mitgo is the general partner and InterMedia Partners IV, L.P. is the limited

[42] Id.

[43] Letter from William E. Kennard, General Counsel of the FCC, to Kenneth J. Kies, Chief of Staff of the Joint Committee on Taxation, dated February 7, 1995.

[44] National Telecommunications and Information Administration, United States Department of Commerce, *Analysis and Compilation of Minority-Owned Commercial Broadcast Stations*, 1994. According to U.S. Census Bureau statistics, minority-owned firms account for slightly under 4 percent of all business revenues.

partner, for approximately $2.3 billion in cash.[45] A subsidiary of TeleCommunications Inc. (a national cable television operator) is one of the limited partners of InterMedia.[46] Recent news reports state that TeleCommunications Inc. will provide "nearly all" of the money for the cable system purchase.[47]

The sale is subject to customary conditions, approvals of local franchise authorities and receipt of an FCC tax certificate.[48] Viacom has indicated that proceeds from the transaction, which is expected to be completed in the second half of 1995, will be used to repay debt.[49]

RCS-Pacific will, in-turn, transfer one of the cable systems (located in Nashville, Tennessee) to another partnership, RCS-Nashville, L.P. RCS-Nashville has substantially the same ownership structure as RCS-Pacific, i.e., Mitgo is the sole general partner (and a 21-percent equity owner) and an affiliate of InterMedia is the sole limited partner (and a 79-percent equity owner).

Under the terms of the RCS-Pacific partnership agreement (as filed with the FCC as part of Viacom's application for an FCC tax certificate), Mitgo Corp., the general partner that is controlled by Mr. Washington, has a put option to be cashed out for the greater of $3 million or the fair market value of its interest (determined by an outside appraiser and subject to a cap). The put option can be exercised between 42 and 46 months after the close of the transaction.

In addition, under the same partnership agreement, InterMedia, the limited partner, has a call option to cash out Mitgo at the same option price described above. The call option can be exercised between 36 and 40 months and after 48 months after the close of the transaction.

Under the terms of the RCS-Nashville partnership agreement, Mitgo has a put option on its RCS-Nashville general partnership interest for the greater of $3 million (plus any amounts outstanding on any loans from the limited partners) or the fair market value of the interest (determined by an outside appraiser and subject to a cap). InterMedia has a call option to cash out Mitgo at the same option price. The exercise period for these options is the same as the exercise period for the RCS-Pacific options. Thus, the combined value of the options under the two partnership agreements is the greater of $6 million or fair market value of the interests.

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[45] Viacom press release dated January 20, 1995.

[46] Id.

[47] "Viacom to Get Big Tax Break in Cable Deal," *Washington Post*, January 4, 1995.

[48] Viacom press release dated January 20, 1995.

[49] Id.

As designed, the sale does not appear to fail any of the standards articulated by the FCC to qualify for a tax certificate pursuant to Code section 1071. Publicly available information indicates that the deferred gain on the Viacom sale can be reasonably expected to be in the range of $1.1 billion to $1.6 billion.[50] The tax deferral, including State tax, could be in the range of $440 million to $640 million.[51] Viacom may be able permanently to defer this gain as a result of utilizing the technique for complying with the requirement to purchase replacement property described in Part II whereby the replacement property is actually purchased from a related corporation within the same controlled group.

In addition, it appears that InterMedia would be eligible to apply for a tax certificate upon sale of its interests in RCS-Pacific and RCS-Nashville as a provider of start-up capital to a minority entity. Thus, InterMedia could defer gain on the sale of its interests in RCS-Pacific and RCS-Nashville, irrespective of whether such sale occurred after Mitgo was no longer a partner (and such partnerships were no longer minority controlled). The revenue costs associated with such a deferral are unknown because they would depend on the amount of deferred gain at the time of the sale.

C. Application of Tax Rules

1. Tax treatment of a seller of broadcast property

General tax rules

Under generally applicable Code provisions, the seller of a business, including a broadcast business, recognizes gain to the extent the sale price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is then subject to the current income tax unless the gain is deferred or not recognized under a special tax provision.

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[50] Securities and Exchange Commission Form 10-K of Viacom Inc. for year ended December 31, 1993.

[51] As a result of the fact that many State income tax systems have what is referred to as a "piggyback" system by which they measure taxable income by reference to the Federal definition of taxable income, section 1071 provides a State tax benefit as well as a Federal tax benefit. For example, if the taxable income deferred in a transaction were $100 million, the Federal tax benefit would be $35 million for a corporate taxpayer while the State tax benefit at a State tax rate of 10 percent would be $10 million, for a total tax benefit of $45 million (before the effect of the deductibility of State taxes).

Special rules under Code section 1031

Under Code section 1031, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like kind" that is to be held for productive use in a trade or business or for investment. The nonrecognition rules do not apply to an exchange of one class or kind of property for property of a different class or kind.[52] The different classes of property are: (1) depreciable tangible personal property; (2) intangible personal property; and (3) real property.[53]

If an exchange consists not only of like-kind property, but also of other property or money, then gain from the transaction is recognized to the extent of the money and the fair market value of the other property, and no loss from the transaction may be recognized. The basis of property received in a like-kind transaction generally is the same as the basis of any property exchanged, decreased by the amount of money received or loss recognized on the exchange and increased by the amount of gain recognized on the exchange. Special rules apply to exchanges between related persons, which generally require the parties to the transaction to hold the exchanged property for at least two years after the exchange.

Special rules under Code section 1033

Under Code section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property. The replacement property may be acquired directly or by acquiring control of a corporation (generally, 80 percent of the stock of the corporation) that owns replacement property. The taxpayer's basis in the replacement property generally is the same as the taxpayer's basis in the converted property, decreased by the amount of any money or loss recognized on the conversion, and increased by the amount of any gain recognized on the conversion.

Only involuntary conversions that result from destruction, theft, seizure, or condemnation (or threat or imminence thereof) are eligible for deferral under Code section 1033. In addition, the term "condemnation" refers to the process by which private property is taken for public use without the consent of the property owner but upon the award and payment of just compensation, according to a ruling by the Internal Revenue Service (IRS).[54] Thus, for example, an order by a Federal court to a corporation to divest itself of ownership of certain stock because of anti-trust rules is not a condemnation (or a threat or imminence thereof), and the divestiture is not eligible

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[52] Treas. Reg. sec. 1.1031(a)-1(b).

[53] Treas. Reg. sec. 1.1031(a)-2.

[54] Rev. Rul. 58-11, 1958-1 C.B. 273.

for deferral under this provision.[55] Under another IRS ruling, the "threat or imminence of condemnation" test is satisfied if, prior to the execution of a binding contract to sell the property, "the property owner is informed, either orally or in writing by a representative of a governmental body or public official authorized to acquire property for public use, that such body or official has decided to acquire his property, and from the information conveyed to him has reasonable grounds to believe that his property will be condemned if a voluntary sale is not arranged."[56] However, under this ruling, the threatened taking also must constitute a condemnation, as defined above.

Special rules under Code section 1071

Under Code section 1071, if the FCC certifies that a sale or exchange of property is necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the FCC with respect to the ownership and control of "radio broadcasting stations," a taxpayer may elect to treat the sale or exchange as an involuntary conversion. The FCC is not required to determine the tax consequences of certifying a sale or to consult with the IRS about the certification process.[57] No other provision of the Internal Revenue Code grants a Federal agency or any other party the type of complete discretion conveyed to the FCC by section 1071.

Under Code section 1071, the replacement requirement in the case of FCC-certified sales may be satisfied by purchasing stock of a corporation that owns broadcasting property, whether or not the stock represents control of the corporation. In addition, even if the taxpayer does not reinvest all the sales proceeds in similar or related replacement property, the taxpayer nonetheless may elect to defer recognition of gain if the basis of depreciable property that is owned by the taxpayer immediately after the sale or that is acquired during the same taxable year is reduced by the amount of deferred gain.

2. **Tax treatment of a buyer of broadcast property**

Under generally applicable Code provisions, the purchaser of a broadcast business, or any other business, acquires a basis equal to the purchase price paid. In an asset acquisition, a buyer must allocate the purchase price among the purchased assets to determine the buyer's basis in these assets. In a stock acquisition, the buyer takes a basis in the stock equal to the purchase price paid, and the business retains its basis in the assets. This treatment applies whether or not the seller of the broadcast property has received an FCC certificate exempting the sale transaction

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[55] Id.

[56] Rev. Rul. 74-8, 1974-1 C.B. 200.

[57] The FCC allows sellers applying for FCC certificates in cable transactions to delete both the sales price and the number of subscribers from the transaction documents submitted with the request for the certificates.

from the normal tax treatment.

D. Economic and Tax Policy Issues Pertaining to Section 1071

1. Economic Analysis

Economic value of Code section 1071 tax benefit

As described in Part I.C.1. above, under Code section 1071 a seller receiving a tax certificate from the FCC may elect one of two options, each of which has the effect of deferring payment, perhaps indefinitely, of some or all of the tax on gain from the sale that would otherwise be payable in the current year. Within two years of the date of sale, the seller may reinvest the proceeds in qualifying broadcast or telecommunications property (replacement property option) and reduce its basis in that property by the amount of the gain deferred. Alternatively, the seller may elect to reduce its basis in qualifying assets that it currently owns (basis reduction option).

Purchase of qualifying replacement property

Under the Federal income tax, a taxpayer generally is liable for tax on the sale of asset when the gain is recognized. Under Code section 1071, the gain on sale of qualifying assets does not result in a tax liability until the taxpayer disposes, if ever, of the replacement property. The value of this deferral of tax liability depends upon the taxpayer's tax rate, the discount rate, and the length of time for which the liability is deferred. For example, suppose a taxpayer recognizes $1 million of gain in 1995. If the taxpayer were in the 35-percent marginal tax bracket, the gain would give rise to a 1995 Federal income tax liability of $350,000. If the taxpayer could defer including the $1 million gain in income until 2005, the taxpayer would have a 2005 income tax liability of $350,000. However, if the interest rate were 10 percent, the 1995 present value of that 2005 liability of $350,000 would be $134,940. The longer the deferral, the smaller the present value of the tax liability. If the taxpayer can defer the liability indefinitely, the tax benefit is equivalent to a complete exemption from tax.

The benefit of deferral depends not only on the taxpayer's current tax rate, but also on its future tax rate. The benefit of deferral is increased for a taxpayer who currently is in a high marginal tax bracket, but who can defer the tax liability until a lower marginal rate applies. The benefit of deferral is decreased if the taxpayer currently is in a low marginal tax bracket and defers the tax liability to a year when a higher marginal tax rate applies. In this circumstance, because of the taxpayer's low initial tax rate, the taxes deferred may actually be worth less (in present value) than the taxes owed at the later date when the taxpayer is in a higher tax bracket.

For individual taxpayers, deferral of tax may result in complete exemption from tax if the taxpayer defers the gain until death. Upon disposition to the taxpayer's heirs, the heirs may "step up" the basis of the bequeathed assets, and any liability from previously deferred gains is eliminated.

Reduction in basis of the taxpayer's existing depreciable assets

If a taxpayer were to elect to reduce the basis of existing depreciable or amortizable assets, rather than purchase qualifying replacement assets, any tax for which the taxpayer would have been liable in the current year is deferred. The reduction in basis of existing assets would reduce any depreciation and amortization deductions that the taxpayer may claim. Reducing current year tax deductions is equivalent to recognizing partially the gain. Reducing future year tax deductions is equivalent to recognizing partially the gain in those future years. By effectively recognizing part of the gain prior to disposition of the assets, not all of the gain is deferred until disposition. Thus, the present value of deferral under the basis reduction option of Code section 1071 is less than if the gain could be fully deferred until disposition (unless the basis reduction is applied against stock, as described in Part II).

Economic incidence of Code section 1071 tax benefit

While the Code specifies that the seller may defer the gain, the economic incidence of the tax benefit provided by Code section 1071 depends upon market conditions. A qualifying buyer could capture all or part of the tax benefit. The seller is interested in the net, after-tax return from the sale of its property. A qualifying buyer could be a successful bidder for a property even though it makes a bid lower than the current market value, or lower than other competing bids, because acceptance of the offer of a qualifying buyer carries the benefit of deferral, while the bids of other potential buyers may not. Hence, the qualifying buyer may be able to offer the seller a higher after-tax return despite offering a lower price. For example, assume the seller owns a property with zero basis and a market value of $1 million. Assume the seller is in the 35-percent tax bracket and that the interest rate is 10 percent. If the seller sold at market value to a non-qualifying buyer, the seller would incur a $350,000 income tax liability in the current year and net $650,000 after tax from the sale. If the seller had the opportunity to defer the recognition of any gain for 10 years, a qualifying buyer could offer $760,000 and that offer would dominate the $1 million offer from the non-qualifying buyer. A $760,000 selling price at a 35-percent marginal tax rate would create a $266,000 tax liability to the seller. If that tax liability could be deferred 10 years at a 10-percent interest rate, it would have present value of $102,554. The sale to the qualified buyer would produce a net, after-tax present value of the sale to the seller of $657,446 ($760,000 less the present value of the tax liability, $102,554).

In general, whether the buyer receives the benefit or the seller receives the benefit depends upon the number of sellers offering properties and the number of qualifying buyers seeking properties. In the example above, if there were a second qualifying buyer, it might bid more than $760,000, because the seller would see any such bid as superior to both the first qualifying buyer and any non-qualifying buyer who offered $1 million or less. If more qualifying buyers competed for a given property, one would expect that they would drive the selling price up, thereby returning some or all of the benefit of deferral to the seller. On the other hand, if many potential sellers offered properties for sale, the number of qualifying buyers might be sufficiently small that the buyer retains most of the tax benefit.

The number of broadcast licenses is limited by the electromagnetic spectrum, and fixed by the FCC. This might imply that the number of properties that could be sold is small relative to the number of potential qualifying buyers and that the tax benefit largely is retained by the seller. On the other hand, the data presented above indicates relatively little minority holding of broadcast licenses. This may imply that the pool of qualifying buyers with experience in the broadcast business is small relative to the number of properties available to be purchased at any one time, with the consequence that all or part of the tax benefit may be transferred to the buyer.

Efficacy of targeted tax preferences for the transfer of broadcast properties

Measuring costs and benefits of the tax preference

The legislative history indicates that Code section 1071 is intended to facilitate certain policies of the FCC. These policies have included, among others, limitations on number of broadcast properties that any one taxpayer may control and the promotion of minority ownership of broadcast properties. A common goal of each of these policies is to provide competition and diversity in the presentation of ideas, news, and entertainment. The Treasury Department has estimated the tax expenditure at $300 million for fiscal year 1995, $315 million for fiscal year 1996, $330 million for fiscal year 1997, $345 million for fiscal year 1998, $360 million for fiscal year 1999, and $380 million for fiscal year 2000, for a six-year cost of $2.03 billion.[58] The tax expenditure may be thought of as an annual Federal subsidy to effectuate these policies. It is more difficult to compute a dollar value for the benefits of these policies. The data reported above indicate that since the 1978 implementation of the policy related to minority ownership, minority ownership of broadcast properties has increased, although not markedly so. Moreover, this increase may be attributable to FCC policies other than its tax certificate program.

Just as it is difficult to measure the aggregate social benefits and costs arising from Code section 1071, it is difficult to measure the social benefits and costs of any individual transaction. An inherent problem arising from providing benefits through the tax system is that a tax benefit may have different values to different taxpayers. Similarly, the social benefits from increased competition and diversity may be expected to vary from community to community. For example, a community already served by ethnically diverse broadcasters would benefit less from the diversity an additional minority broadcaster might bring to the community than would a community currently served by no such broadcasters. In developing its rule on granting tax certificates, the FCC does not take into account the size of the potential tax benefit involved and attempt to weigh this against the benefits to the affected community that may arise from increased competition and diversity. Indeed, the FCC does not request information concerning the

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[58] Executive Office of the President, Office of Management and Budget, *Budget of the United States Government, Analytical Perspectives, Fiscal Year 1996*, Washington, D.C., 1995, p. 49. The Joint Committee on Taxation recently estimated that repeal of Code section 1071 (as proposed in H.R. 831) would increase Federal revenues by $1.386 billion over the period 1995 through 2000. H. Rept. No. 104-32, 104th Cong., 1st Sess., 26 (1995).

magnitude of the tax benefit granted in determining whether to issue tax certificates.

The cost, in deferred taxes, of any one transaction also will vary because the value of broadcast properties varies with the markets they serve. However the benefit of deferred taxes under Code section 1071 always depends, in part, on the sales price of the property. The market value of a broadcast property depends on its potential viewers or listeners, that is, on the size of the market served. If the goal is to further competition and diversity, there may be no reason to deny a certificate merely because of the size of the transaction, because a large transaction value generally implies a large market or several markets are involved.

Issues of equity

A tax preference for the transfer of broadcast properties may cause taxpayers who do not receive a benefit to perceive the tax system as unfair. The incidence of the tax benefit may be uncertain, but a comparable tax benefit is not provided for the sale of other business assets. This creates horizontal inequities in taxation. Otherwise similarly situated individuals or businesses do not incur the same tax liabilities. One might argue that the case of broadcast licenses is different because the industry is regulated and availability is limited by technology and the electromagnetic spectrum. On the other hand, similar treatment is not offered in other regulated industries or where nature or technology limits supply (e.g., telephone service or landing rights at airports).

Administrative difficulties of targeting benefits through the tax system

Tax benefits are similar to open-ended entitlements available to all who may legally claim them. Providing tax benefits to encourage certain policy outcomes may have the advantage of leaving the market system to allocate the benefit, rather than creating an administrative agency to identify eligible individuals and disburse subsidies. However, targeting tax benefits may be difficult without incurring administrative and compliance costs. For example, in providing tax benefits to sellers for sales to minority purchasers under Code section 1071, the FCC must certify the purchaser as a qualified minority purchaser. In practice, the FCC must engage in a review and certification process equivalent to one that might occur under a direct expenditure program. There is a tradeoff between having targeting in a program and having limited administrative involvement. In the case of Code section 1071, two administrative agencies are involved. The IRS is not expert in the business of broadcast properties and the FCC is not expert in tax administration. Coordination on administrative matters and policy goals between the IRS and the FCC may be difficult to achieve.

2. Congressional Oversight of Code Section 1071

As drafted, Code section 1071 permits the FCC to grant qualifying certificates in transfers that further FCC policy goals. This leaves the granting of the tax benefit largely in the hands of the FCC.

There are other programs where the Congress has delegated to other agencies the ability to deliver tax benefits. For example, under the low-income housing tax credit (Code section 42) and in the case of certain private activity tax-exempt bonds (Code section 141), State agencies are authorized to certify taxpayers to receive certain Federal income tax benefits. In each of those programs, however, the Congress has not left the policy goals to the agency and has limited the total amount of benefit that the agencies may grant in any one year. Code section 7518 may be another related example. Section 7518 provides certain tax benefits to the owners of nautical vessels used in the foreign or domestic commerce of the United States or in the fisheries of the United States to the extent such owners establish a fund under section 607 of the Merchant Marine Act, 1936. The determination of whether a taxpayer may establish such a fund generally is made pursuant to an agreement with the Secretary of Transportation or Commerce. Allowing a Federal agency to provide an open-ended amount of tax benefits is akin to providing a discretionary entitlement that is not governed by the Congressional appropriations process.

II. INVOLUNTARY CONVERSIONS UNDER CODE SECTION 1033

As described in Part I.C.1., under Code section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property.

Under rulings issued by the IRS to taxpayers, property (stock or assets) purchased from a related person may, in some cases, qualify as property similar or related in service or use to the converted property.[59] Thus, in certain circumstances, related taxpayers may obtain significant (and possibly indefinite or permanent) tax deferral without any additional cash outlay to acquire new properties. In cases in which a taxpayer purchases stock as replacement property, section 1033 permits the taxpayer to reduce basis of stock, but does not require any reduction in the basis of the underlying assets. Thus, the reduction in basis does not result in reduced depreciation deductions.

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[59] See, e.g., PLR 8132072, PLR 8020069. Private letter rulings do not have precedential authority and may not be relied upon by any taxpayer other than the taxpayer receiving the ruling but are some indication of IRS administrative practice.

III. DESCRIPTION OF SECTIONS 2 AND 3 OF H.R. 831

A. In General

On February 21, 1995, the House of Representatives passed H.R. 831 by a vote of 381 to 44. As passed, H.R. 831 would (1) extend permanently the 25-percent deduction for health insurance costs for self-employed individuals; (2) repeal the provision permitting nonrecognition of gain on sales and exchanges effectuating policies of the FCC; (3) provide that the nonrecognition of gain on involuntary conversions is not to apply if replacement property is acquired from a related person; and (4) deny the EITC to individuals who have more than $3,150 of taxable interest and dividend income and phase out the EITC for individuals with more than $2,500 of taxable interest and dividend income.[60]

B. Repeal of Code Section 1071 (sec. 2 of the bill)

Section 2 of the bill repeals Code section 1071. Thus, a sale or exchange of broadcast properties would be subject to the same tax rules applicable to all other taxpayers engaged in the sale or exchange of a business. The repeal of section 1071 is effective for (1) sales or exchanges on or after January 17, 1995[61], and (2) sales or exchanges before that date if the FCC tax certificate with respect to the sale or exchange is issued on or after that date. The provision does not apply to taxpayers who have entered into a binding written contract (or have completed a sale or exchange pursuant to a binding written contract) before January 17, 1995, and who have applied for an FCC tax certificate by that date. A contract is treated as not binding for this purpose if the sale or exchange pursuant to the contract (or the material terms of the contract) were contingent on January 16, 1995, on issuance of an FCC tax certificate. A sale or exchange would not be contingent on January 16, 1995, on issuance of an FCC tax certificate if the tax certificate had been issued by the FCC by that date.

C. Modification of Code Section 1033 (sec. 3 of the bill)

Under section 3 of the bill, a taxpayer may not defer gain under Code section 1033 when the replacement property or stock is purchased from a related person. For purposes of the bill, a person is treated as related to another person if the relationship between the persons would result

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[60] For a description of H.R. 831, as reported by the House Committee on Ways and Means, see H. Rept. No. 104-32, 104th Cong., 1st Sess. (1995).

[61] On January 17, 1995, House Committee on Ways and Means Chairman Archer issued a press release announcing that the Committee on Ways and Means would immediately review the operation of section 1071 to explore possible legislative changes to section 1071, including the possibility of repeal. The press release stated that any changes to section 1071 may apply to transactions completed, or certificates issued by the FCC, on or after the date of the announcement.

IV. EARNED INCOME TAX CREDIT

A. Present Law

EITC, in general

Eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit an eligible taxpayer may claim depends upon whether the taxpayer has one, more than one, or no qualifying children and is determined by multiplying the credit rate by the taxpayer's earned income up to an earned income threshold. The maximum amount of the credit is the product of the credit rate and the earned income threshold. For taxpayers with earned income (or adjusted gross income, if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or adjusted gross income, if greater) in excess of the phaseout threshold. The credit is not allowed if earned income (or adjusted gross income, if greater) exceeds the phaseout limit.

The parameters for the EITC depend upon the number of qualifying children the taxpayer claims. For 1995 the parameters are as follows:

	Two or more qualifying children--	One qualifying child--	No qualifying children--
Credit rate	36.00%	34.00%	7.65%
Phaseout rate	20.22%	15.98%	7.65%
Earned income threshold	$8,640	$6,160	$4,100
Maximum credit	$3,110	$2,094	$314
Phaseout threshold	$11,290	$11,290	$5,130
Phaseout limit	$26,673	$24,396	$9,230

The earned income threshold and the phaseout threshold are indexed for inflation; because the phaseout limit depends on those amounts, the phaseout rate, and the credit rate, the phaseout limit will also increase if there is inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

The credit rates and phaseout rates for the EITC change over time under present law. For 1996 and after, the credit rate will be 40 percent and the phaseout rate will be 21.06 percent for taxpayers with two or more qualifying children. The credit rate and the phaseout rate for taxpayers with one qualifying child or no qualifying children will be the same as those listed in the in a disallowance of losses under the rules of Code section 267 or 707(b). This provision is intended to apply to all cases involving relationships to the taxpayer described in Code sections 267(b) or 707(b)(1), including members of controlled groups under Code section 267(f). The prohibition against nonrecognition of gain in certain related-party transactions applies to replacement property or stock acquired on or after February 6, 1995 (the date of introduction of H.R. 831).

table above.

In order to claim the EITC, a taxpayer must either have a qualifying child or must meet other requirements. A qualifying child must meet a relationship test, an age test, an identification test, and a residence test. In order to claim the EITC without a qualifying child, a taxpayer must not be a dependent and must be over age 24 and under age 65.

To satisfy the identification test for a qualifying child, taxpayers must include on their tax return the name and age of each qualifying child. For returns filed with respect to tax year 1995, taxpayers must provide a taxpayer identification number (TIN) for all qualifying children who were born on or before October 31, 1995. For returns filed with respect to tax year 1996, taxpayers must provide TINs for all qualifying children born on or before November 30, 1996. For returns filed with respect to tax year 1997 and all subsequent years, taxpayers must provide TINs for all qualifying children, regardless of their age.

A taxpayer's TIN is generally that taxpayer's social security number. Some taxpayers are exempted from social security self-employment taxes because of their religious beliefs. These taxpayers do not have a social security number; instead, the Internal Revenue Service administratively assigns them a taxpayer identification number.

Nonresidents and the EITC

The EITC may be claimed by a taxpayer meeting the above requirements if the taxpayer is a U.S. citizen or a resident alien.

Section 7701(b) defines a resident alien for income tax purposes. Aliens who do not meet this definition are nonresident aliens. For income tax purposes, an individual is generally considered a resident if the individual:

(1) has entered the United States as a lawful permanent U.S. resident (the "green card test"); or

(2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for 183 or more days during a three-year period weighted toward the present year (the "substantial presence test"). (An individual who is present in the United States for fewer than 183 days and establishes that he has a closer connection with a foreign country than with the United States is generally not subject to tax as a resident alien on account of the substantial presence test.)

The implementing legislation for the General Agreements on Tariffs and Trade (P.L. 103-465) made individuals who are nonresident aliens for any portion of the taxable year ineligible to claim the EITC for taxable years beginning after December 31, 1994, unless an election under Code section 6013(g) or (h) is in effect for the taxable year.

Under section 6013(g), a nonresident alien who is married to an individual who is either a citizen or resident alien of the United States at year end may elect to be treated as a resident for the entire year. The election applies to the year for which it is made and all subsequent years until terminated. However, the election will be suspended if neither spouse is a U.S. citizen or resident at any time during a taxable year.

Under section 6013(h), an individual who (1) is a nonresident alien at the beginning of the year and a resident alien at the end of the year and (2) is married to an individual who is either a citizen or resident of the United States at year end may elect to be treated as a resident for the entire year. Thus, this election can be made by a foreign married couple who arrive in the United States during the taxable year and who are resident aliens at year end.

Mathematical errors

The IRS may summarily assess additional tax due as a result of a mathematical error without sending the taxpayer a notice of deficiency and an opportunity to petition the Tax Court. Where the IRS uses the summary assessment procedure for mathematical or clerical errors, the taxpayer must be given an explanation of the asserted error and a period of 60 days to request that the IRS abate its assessment. The IRS may not proceed to collect the amount of the assessment until the taxpayer has agreed to it or has allowed the 60-day period for objecting to expire. If the taxpayer files a request for abatement of the assessment specified in the notice, the IRS must abate the assessment. Any reassessment of the abated amount is subject to the ordinary deficiency procedures. This procedure is the only one a taxpayer may use for contesting an assessment arising out of a mathematical or clerical error.

B. Description of Administration Proposal and Section 4 of H.R. 831

1. President Clinton's Fiscal Year 1996 Budget Proposal

Earned income tax credit denied to individuals not authorized to be employed in the United States

Taxpayers would not be eligible for the EITC if they do not include their taxpayer identification number (and, if married, their spouse's taxpayer identification number) on their tax return. Solely for these purposes and for purposes of the present-law identification test for a qualifying child, a taxpayer identification number would be defined as a social security number issued to an individual by the Social Security Administration other than a number issued under section 205(c)(2)(B)(i)(II) (or that portion of 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act (regarding the issuance of a number to an individual applying for or receiving Federally funded benefits). Thus, if an individual obtained a social security number solely because that individual is an applicant for, or a recipient of, Federally funded benefits, the individual would be ineligible to claim the EITC.

If a taxpayer fails to provide a correct taxpayer identification number, such omission would be treated as a mathematical or clerical error. Thus, any notification that the taxpayer owes additional tax because of that omission would not be treated as a notice of deficiency.

Earned income tax credit denied to individuals with substantial unearned income

A taxpayer would not be eligible for the EITC if the aggregate amount of interest and dividends includible in his income for the taxable year exceeds $2,500. For taxable years beginning after 1996, the $2,500 limit would be indexed for inflation with rounding to the nearest multiple of $50.

These proposals would be effective for taxable years beginning after December 31, 1995.

2. **Section 4 of H.R. 831**

Section 4 of H.R. 831 provides that a taxpayer is not eligible for the EITC if the aggregate amount of interest and dividends includible in his or her income for the taxable year exceeds $3,150. The otherwise allowable EITC amount is phased out ratably for taxpayers with aggregate taxable interest and dividend income between $2,500 and $3,150. For taxable years beginning after 1996, the $2,500 threshold and the $650 size of the phaseout will be indexed for inflation, with rounding to the nearest multiple of $10.

The provision is effective for taxable years beginning after December 31, 1995.

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